ARROW ELECTRONICS INC
Form 10-Q
November 01, 2018
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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 quarterly period ended September 29, 2018

OR

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

For the transition period from _____ to _____

Commission file number 1-4482

ARROW ELECTRONICS INC(Exact name of registrant as specified in its charter)

New York	**11-1806155**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
9201 East Dry Creek Road, Centennial, Colorado	**80112**
(Address of principal executive offices)	(Zip Code)

(303) 824-4000
(Registrant's telephone number, including area code)

No Changes
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes x No o

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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes x No o

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

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (do not check if a smaller reporting company)	Smaller reporting company o
	Emerging growth company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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

Yes o No x

There were 87,172,144 shares of Common Stock outstanding as of October 30, 2018.

ARROW ELECTRONICS, INC.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

ARROW ELECTRONICS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands except per share data)
(Unaudited)

	Quarter Ended		Nine Months Ended	
	September 29, 2018	September 30, 2017	September 29, 2018	September 30, 2017
		(Adjusted)		(Adjusted)
Sales	$7,490,445	$ 6,856,108	$21,758,586	$ 19,015,114
Cost of sales	6,566,667	6,013,541	19,033,044	16,587,326
Gross profit	923,778	842,567	2,725,542	2,427,788
Operating expenses:				
Selling, general, and administrative expenses	575,751	552,656	1,719,108	1,599,963
Depreciation and amortization	45,532	38,574	139,201	113,096
Loss on disposition of businesses, net	2,042	—	3,604	—
Restructuring, integration, and other charges	10,143	15,896	50,497	55,817
	633,468	607,126	1,912,410	1,768,876
Operating income	290,310	235,441	813,132	658,912
Equity in earnings (losses) of affiliated companies	(652)	1,216	(808)	2,865
Gain (loss) on investments, net	1,070	(13,029)	(3,945)	(8,784)
Loss on extinguishment of debt	—	786	—	59,545
Employee benefit plan expense	1,296	1,850	3,784	5,547
Interest and other financing expense, net	54,205	40,111	160,187	120,898
Income before income taxes	235,227	180,881	644,408	467,003
Provision for income taxes	57,054	45,972	155,325	115,128
Consolidated net income	178,173	134,909	489,083	351,875
Noncontrolling interests	1,640	845	3,541	3,352
Net income attributable to shareholders	$176,533	$ 134,064	$485,542	$ 348,523
Net income per share:				
Basic	$2.02	$ 1.52	$5.53	$ 3.92
Diluted	$1.99	$ 1.50	$5.47	$ 3.88
Weighted-average shares outstanding:				
Basic	87,602	88,453	87,785	88,870
Diluted	88,608	89,540	88,759	89,936

See accompanying notes.

ARROW ELECTRONICS, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands)
(Unaudited)

	Quarter Ended		Nine Months Ended	
	September 30, 2018	September 30, 2017 (Adjusted)	September 30, 2018	September 30, 2017 (Adjusted)
Consolidated net income	$178,173	$ 134,909	$489,083	$ 351,875
Other comprehensive income:				
Foreign currency translation adjustment and other	(38,008)	54,893	(139,846)	225,270
Unrealized gain on investment securities, net	—	1,357	—	4,639
Unrealized gain (loss) on interest rate swaps designated as cash flow hedges, net	234	(2,093)	693	(2,543)
Employee benefit plan items, net	389	492	1,284	1,403
Other comprehensive income (loss)	(37,385)	54,649	(137,869)	228,769
Comprehensive income	140,788	189,558	351,214	580,644
Less: Comprehensive income attributable to noncontrolling interests	1,497	2,049	1,486	7,743
Comprehensive income attributable to shareholders	$139,291	$ 187,509	$349,728	$ 572,901

See accompanying notes.

ARROW ELECTRONICS, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands except par value)
(Unaudited)

	September 29, 2018	December 31, 2017 (Adjusted)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 474,191	$ 730,083
Accounts receivable, net	8,229,791	8,125,588
Inventories	3,722,808	3,302,518
Other current assets	292,641	256,028
Total current assets	12,719,431	12,414,217
Property, plant, and equipment, at cost:		
Land	13,168	12,866
Buildings and improvements	159,754	160,664
Machinery and equipment	1,415,619	1,330,730
	1,588,541	1,504,260
Less: Accumulated depreciation and amortization	(749,978)	(665,785)
Property, plant, and equipment, net	838,563	838,475
Investments in affiliated companies	85,175	88,347
Intangible assets, net	313,472	286,215
Goodwill	2,659,335	2,470,047
Other assets	362,049	361,966
Total assets	$ 16,978,025	$ 16,459,267
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$ 6,886,217	$ 6,756,830
Accrued expenses	797,088	841,675
Short-term borrowings, including current portion of long-term debt	158,153	356,806
Total current liabilities	7,841,458	7,955,311
Long-term debt	3,352,128	2,933,045
Other liabilities	482,397	572,971
Commitments and contingencies (Note M)		
Equity:		
Shareholders' equity:		
Common stock, par value $1:		
Authorized - 160,000 shares in both 2018 and 2017, respectively		
Issued - 125,424 shares in both 2018 and 2017, respectively	125,424	125,424
Capital in excess of par value	1,129,345	1,114,167
Treasury stock (38,251 and 37,733 shares in 2018 and 2017, respectively), at cost	(1,824,373)	(1,762,239)
Retained earnings	6,104,682	5,596,786
Accumulated other comprehensive loss	(283,051)	(124,883)
Total shareholders' equity	5,252,027	4,949,255
Noncontrolling interests	50,015	48,685
Total equity	5,302,042	4,997,940
Total liabilities and equity	$ 16,978,025	$ 16,459,267

See accompanying notes.

ARROW ELECTRONICS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended	
	September 30, 2018	September 30, 2017 (Adjusted)
Cash flows from operating activities:		
Consolidated net income	$489,083	$ 351,875
Adjustments to reconcile consolidated net income to net cash provided by operations:		
Depreciation and amortization	139,201	113,096
Amortization of stock-based compensation	38,104	30,301
Equity in (earnings) losses of affiliated companies	808	(2,865)
Loss on extinguishment of debt	—	59,545
Deferred income taxes	17,769	13,262
Loss on investments, net	3,945	9,504
Other	9,660	7,415
Change in assets and liabilities, net of effects of acquired and disposed businesses:		
Accounts receivable	(254,417)	(26,286)
Inventories	(456,050)	(261,126)
Accounts payable	171,697	(113,804)
Accrued expenses	15,177	(42,267)
Other assets and liabilities	(165,421)	(136,871)
Net cash provided by operating activities	9,556	1,779
Cash flows from investing activities:		
Cash consideration paid for acquired businesses, net of cash acquired	(331,563)	(3,628)
Proceeds from disposition of businesses	32,013	—
Acquisition of property, plant, and equipment	(104,897)	(149,597)
Proceeds from sale of property, plant, and equipment	—	24,433
Other	(11,000)	(2,467)
Net cash used for investing activities	(415,447)	(131,259)
Cash flows from financing activities:		
Change in short-term and other borrowings	104,158	(14,423)
Proceeds from (repayments of) long-term bank borrowings, net	420,755	(82,766)
Proceeds from note offerings, net	—	987,144
Redemption of notes	(300,000)	(555,886)
Proceeds from exercise of stock options	7,919	21,423
Repurchases of common stock	(93,173)	(149,125)
Purchase of shares from noncontrolling interest	—	(23,350)
Other	(1,174)	(1,620)
Net cash provided by financing activities	138,485	181,397
Effect of exchange rate changes on cash	11,514	(1,898)
Net increase (decrease) in cash and cash equivalents	(255,892)	50,019
Cash and cash equivalents at beginning of period	730,083	534,320
Cash and cash equivalents at end of period	$474,191	$ 584,339

See accompanying notes.

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ARROW ELECTRONICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)
(Unaudited)

Note A – Basis of Presentation

The accompanying consolidated financial statements of Arrow Electronics, Inc. (the "company") were prepared in accordance with accounting principles generally accepted in the United States and reflect all adjustments of a normal recurring nature, which are, in the opinion of management, necessary for a fair presentation of the consolidated financial position and results of operations at and for the periods presented. The consolidated results of operations for the interim periods are not necessarily indicative of results for the full year.

These consolidated financial statements do not include all of the information or notes necessary for a complete presentation and, accordingly, should be read in conjunction with the company's audited consolidated financial statements and accompanying notes for the year ended December 31, 2017, as filed in the company's Annual Report on Form 10-K.

Quarter End

The company operates on a quarterly calendar that closes on the Saturday closest to the end of the calendar quarter.

Reclassification

Certain prior period amounts were reclassified to conform to the current period presentation (See Note B). These reclassifications are included in the footnote tables for the third quarter and nine months ended September 29, 2018.

Note B – Impact of Recently Issued Accounting Standards

In August 2018, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update No. 2018-15, *Intangibles—Goodwill and Other— Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract (a consensus of the FASB Emerging Issues Task Force)* ("ASU No. 2018-15"). ASU No. 2018-15 aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop internal-use software. ASU No. 2018-15 is effective for the company in the first quarter of 2020, with early adoption permitted, and is to be applied either retrospectively or prospectively. The company is currently evaluating the potential effects of adopting the provisions of ASU No. 2018-15.

In February 2018, the FASB issued Accounting Standards Update No. 2018-02, *Income Statement - Reporting Comprehensive Income (Topic 220)* ("ASU No. 2018-02"). ASU No. 2018-02 provides financial statement preparers with an option to reclassify stranded tax effects within accumulated other comprehensive income to retained earnings in each period that is impacted by U.S. federal government tax legislation enacted in 2017. Effective January 1, 2018, the company adopted the provisions of ASU No. 2018-02 on a prospective basis as an adjustment to retained earnings of $4,116.

In August 2017, the FASB issued Accounting Standards Update No. 2017-12, *Derivatives and Hedging (Topic 815)* ("ASU No. 2017-12"). ASU No. 2017-12 simplifies certain aspects of hedge accounting and results in a more accurate portrayal of the economics of an entity’s risk management activities in its financial statements. ASU No. 2017-12 is effective for the company in the first quarter of 2019, with early adoption permitted, and is to be applied on a modified retrospective basis. The company is currently evaluating the potential effects of adopting the provisions of ASU No.

2017-12.

In March 2017, the FASB issued Accounting Standards Update No. 2017-07, *Compensation - Retirement Benefits (Topic 715)* ("ASU No. 2017-07"). ASU No. 2017-07 requires that the service cost component of pension expense be included in the same line item as other compensation costs arising from services rendered by employees, with the other components of pension expense being classified outside of a subtotal of income from operations. Effective January 1, 2018, the company adopted the provisions of ASU No. 2017-07 on a retrospective basis for the presentation requirements.

In June 2016, the FASB issued Accounting Standards Update No. 2016-13, *Financial Instruments - Credit Losses (Topic 326)* ("ASU No. 2016-13"). ASU No. 2016-13 revises the methodology for measuring credit losses on financial instruments and the timing of when such losses are recorded. ASU No. 2016-13 is effective for the company in the first quarter of 2020, with early

ARROW ELECTRONICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)
(Unaudited)

adoption permitted, and is to be applied using a modified retrospective approach. The company is currently evaluating the potential effects of adopting the provisions of ASU No. 2016-13.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, *Leases (Topic 842)* ("ASU No. 2016-02"). ASU No. 2016-02 requires the entity to recognize the assets and liabilities for the rights and obligations created by leased assets. Leases will be classified as either finance or operating, with classification affecting expense recognition in the income statement. In July 2018 the FASB issued ASU No. 2018-10, *Codification Improvements to Topic 842, Leases*, and ASU No. 2018-11, *Leases (Topic 842) Targeted Improvements*, which provide supplemental adoption guidance and clarification to ASU No. 2016-02, and must be adopted concurrently with the adoption of ASU No. 2016-02, cumulatively referred to as “Topic 842”. Topic 842 is effective for the company in the first quarter of 2019, with early adoption permitted, and is to be applied using either a modified retrospective approach, or an optional transition method which allows an entity to apply the new standard at the adoption date with a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption.

The company expects to adopt Topic 842 in the first quarter of 2019 under the optional transition method described above. In addition, the company will elect the short-term lease exception outlined in ASC 842. While the company continues to evaluate the effects of adopting the provisions of Topic 842, the company expects most existing operating lease commitments will be recognized as operating lease liabilities and right-of-use assets upon adoption. The adoption is not expected to be material to the financial statements, and based on our ongoing assessment, will increase total assets by less than 3%.

In January 2016, the FASB issued Accounting Standards Update No. 2016-01, *Financial Instruments - Recognition and Measurement of Financial Assets and Financial Liabilities (Topic 825)* ("ASU No. 2016-01"). ASU No. 2016-01 revises the classification and measurement of investments in certain equity investments and the presentation of certain fair value changes for certain financial liabilities measured at fair value. ASU No. 2016-01 requires the change in fair value of many equity investments to be recognized in net income. Effective January 1, 2018, the company adopted the provisions of ASU No. 2016-01 on a prospective basis as an adjustment to retained earnings of $18,238.

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* ("ASU No. 2014-09"). ASU No. 2014-09 supersedes all existing revenue recognition guidance. Under ASU No. 2014-09, an entity should recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In March, April, May, and December 2016, the FASB issued ASU No. 2016-08, *Revenue from Contracts with Customers: Principal versus Agent Considerations* (*Reporting Revenue Gross versus Net)* ("ASU No. 2016-08"); ASU No. 2016-10, *Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing* ("ASU No. 2016-10"); ASU No. 2016-12, *Revenue from Contracts with Customers: Narrow-Scope Improvements and Practical Expedients* ("ASU No. 2016-12"); and ASU No. 2016-19, *Technical Corrections and Improvements* ("ASU No. 2016-19"), respectively. ASU No. 2016-08, ASU No. 2016-10, ASU No. 2016-12, and ASU No. 2016-19 provide supplemental adoption guidance and clarification to ASU No. 2014-09, and must be adopted concurrently with the adoption of ASU No. 2014-09, cumulatively referred to as "Topic 606".

On January 1, 2018, the company adopted Topic 606 applying the full retrospective method. The primary impact of adoption relates to the application of principal versus agent indicators and the determination of whether goods and services are distinct. In addition, the company is deferring certain revenue due to the determination of when transfer of control occurs. The deferrals are expected to be recognized within a year of the transaction date.

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ARROW ELECTRONICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)
(Unaudited)

The following table presents the effect of the adoption of Topic 606, ASU No. 2017-07, and other prior period reclassifications.

	Quarter Ended September 30, 2017			Nine Months Ended September 30, 2017		
	As Previously Reported	Adjustments**	Adjusted for New Standards	As Previously Reported	Adjustments**	Adjusted for New Standards
Sales	$6,953,740	$ (97,632)	$6,856,108	$19,178,638	$ (163,524)	$19,015,114
Cost of sales	6,110,382	(96,841)	6,013,541	16,751,427	(164,101)	16,587,326
Gross profit	843,358	(791)	842,567	2,427,211	577	2,427,788
Operating expenses:						
Selling, general, and administrative expenses	552,896	(240)	552,656	1,600,762	(799)	1,599,963
Depreciation and amortization	38,574	—	38,574	113,096	—	113,096
Restructuring, integration, and other charges	15,896	—	15,896	55,817	—	55,817
	607,366	(240)	607,126	1,769,675	(799)	1,768,876
Operating income	235,992	(551)	235,441	657,536	1,376	658,912
Equity in earnings of affiliated companies	1,216	—	1,216	2,865	—	2,865
Gain (loss) on investments, net	(15,000)	1,971	(13,029)	(14,250)	5,466	(8,784)
Loss on extinguishment of debt	786	—	786	59,545	—	59,545
Employee benefit plan expense	—	1,850	1,850	—	5,547	5,547
Interest and other financing expense, net	39,748	363	40,111	120,179	719	120,898
Income before income taxes	181,674	(793)	180,881	466,427	576	467,003
Provision for income taxes	46,199	(227)	45,972	114,998	130	115,128
Consolidated net income	135,475	(566)	134,909	351,429	446	351,875
Noncontrolling interests	845	—	845	3,352	—	3,352
Net income attributable to shareholders	134,630	(566)	134,064	348,077	446	348,523
Net income per share:						
Basic*	$1.52	$ —	$1.52	$3.92	$ —	$3.92
Diluted*	$1.50	$ —	$1.50	$3.87	$ 0.01	$3.88

* The sum of the as previously reported and as adjusted may not agree to totals, as presented, due to rounding.
** Topic 606 impacted sales and cost of sales. ASU No. 2017-07 and other reclassifications impacted operating and non-operating expenses.

ARROW ELECTRONICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)
(Unaudited)

The following table presents the effect of the adoption of Topic 606, ASU No. 2017-07, and other prior period reclassifications for 2017.

	First Quarter		Second Quarter		Third Quarter		Fourth Quarter		Year to Date	
	As Previously Reported	Adjusted for New Standards	As Previously Reported	Adjusted for New Standards	As Previously Reported	Adjusted for New Standards	As Previously Reported	Adjusted for New Standards	As Previously Reported	Adjusted for New Standards
2017										
Sales	$5,759,552	$5,736,780	$6,465,346	$6,422,226	$6,953,740	$6,856,108	$7,633,870	$7,539,449	$26,812,508	$26,554,563
Cost of sales	4,999,665	4,975,583	5,641,380	5,598,202	6,110,382	6,013,541	6,703,742	6,610,269	23,455,169	23,197,595
Operating income	191,722	193,025	229,822	230,446	235,992	235,441	270,914	286,824	928,450	945,736
Net income attributable to shareholders	$113,768	$114,737	$99,679	$99,722	$134,630	$134,064	$53,885	$53,653	$401,962	$402,176

Operating income for the fourth quarter of 2017 was impacted by a reclassification of pension settlement expense of $16,706 due to the implementation of ASU No. 2017-07. The settlement expense was moved to "Employee benefit plan expense", which is classified as non-operating on the statement of operations.

Note C – Significant Accounting Policies

Except for the changes below, no material changes have been made to the company's significant accounting policies disclosed in Note 1, Summary of Significant Accounting Policies, in its Annual Report on Form 10-K, filed on February 6, 2018, for the year ended December 31, 2017.

Revenue Recognition

Revenue is recognized at the point at which control of the underlying goods or services are transferred to the customer, which included determining whether goods and services are distinct and separate performance obligations, which may require significant judgment. Satisfaction of the company’s performance obligations occur upon the transfer of control of goods or services, either from the company’s facilities or directly from suppliers to customers. The company considers customer purchase orders, which in some cases are governed by master agreements, to be the contracts with a customer. All revenue is generated from contracts with customers.

In determining the transaction price, the company evaluates whether the price is subject to refund or adjustment to determine the net consideration to which the company expects to receive. The amount of consideration received and revenue recognized by the company vary due to contractually defined incentives and return rights that are held by customers. These adjustments are made in the same period as the underlying transactions.

Investments

The changes in fair value of equity investments, for which the company does not possess the ability to exercise significant influence, are recognized in net income. The fair values of these equity investments are based upon readily determinable fair values (Note I).

Income Taxes

In the fourth quarter of 2017, the company recorded a provision amount of $124,749 , which is a reasonable estimate of the impact of U.S. federal government tax legislation enacted in 2017 (the “Tax Act”) pursuant to the guidance

provided by the U.S. Securities and Exchange Commission's Staff Accounting Bulletin ("SAB 118"), which allows the company a measurement period of up to one year after the enactment date of the Tax Act to finalize the recording of the related provisional tax impacts. Accordingly, the company is continuing to assess the related tax impacts under SAB 118 and has not made any adjustments during the first nine months of 2018 to the reasonable estimate of $124,749 previously recorded in the fourth quarter of 2017.

ARROW ELECTRONICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)
(Unaudited)

Note D – Acquisitions

2018 Acquisitions

On January 8, 2018, the company acquired eInfochips for a purchase price of $327,628, which included $14,769 of cash acquired. eInfochips services customers at every phase of technology deployment, including custom hardware and software, and new Internet of Things based business models. eInfochips is recorded in the company's global components business segment.

Since the date of the acquisition, eInfochips sales of $64,871 were included in the company's consolidated results of operations.

The purchase price allocation is preliminary and subject to adjustment based on our final assessment of fair value of the acquired assets and liabilities. Items initially estimated and subject to change upon finalization of the valuation include goodwill, intangibles, and deferred taxes. The following table summarizes the preliminary allocation of the net consideration paid to the fair value of the assets acquired and liabilities assumed for the eInfochips acquisition:

Accounts receivable, net	$13,701
Inventories	1,512
Property, plant, and equipment	4,557
Other assets	23,733
Identifiable intangible assets	71,710
Goodwill	230,237
Accounts payable	(521)
Accrued expenses	(8,595)
Deferred tax liability	(21,969)
Other liabilities	(1,506)
Cash consideration paid, net of cash acquired	$312,859

In connection with the eInfochips acquisition, the company allocated $71,710 to customer relationships with a weighted-average life of 9 years.

The goodwill related to the eInfochips acquisition was recorded in the company's global components business segment and is not tax deductible.

During the first nine months of 2018, the company completed one additional acquisition with a purchase price of approximately $18,704, net of cash acquired. The impact of this acquisition was not material to the company's consolidated financial position or results of operations.

The following table summarizes the company's unaudited consolidated results of operations for the third quarter and first nine months of 2017, as well as the unaudited pro forma consolidated results of operations of the company, as though the 2018 acquisitions occurred on January 1, 2017:

	Quarter Ended	**Nine Months Ended**
	September 30, 2017	

			September 30, 2017				
	As Reported	Pro Forma	As Reported	Pro Forma			
Sales	$6,856,108	$6,891,648	$				

	Defined Benefit Plan Liability	Cash Flow Hedges	Foreign Currency Translation Adjustment	Total Pre-Tax Amount	Tax	Net-of-Tax Amount
At April 3, 2015	$(1,181)	$(3,480)	$9,625	$4,964	$ 1,734	$6,698
Unrealized loss on cash flow hedges	—	(840)	—	(840)	295	(545)
Realized loss on foreign currency hedges	—	420	—	420	(147)	273
Realized loss on interest rate swap hedges	—	281	—	281	(98)	183
Foreign currency translation gain	—	—	214	214	—	214
At July 3, 2015	$(1,181)	$(3,619)	$9,839	$5,039	$ 1,784	$6,823

	Defined Benefit Plan Liability	Cash Flow Hedges	Foreign Currency Translation Adjustment	Total Pre-Tax Amount	Tax	Net-of-Tax Amount
At January 2, 2015	$(1,181)	$(2,558)	$11,450	$7,711	$1,412	$9,123
Unrealized loss on cash flow hedges	—	(2,187)	—	(2,187)	766	(1,421)
Realized loss on foreign currency hedges	—	664	—	664	(232)	432
Realized loss on interest rate swap hedges	—	462	—	462	(162)	300
Foreign currency translation loss	—	—	(1,611)	(1,611)	—	(1,611)
At July 3, 2015	$(1,181)	$(3,619)	$9,839	$5,039	$1,784	$6,823

	Defined Benefit Plan Liability	Cash Flow Hedges	Foreign Currency Translation Adjustment	Total Pre-Tax Amount	Tax	Net-of-Tax Amount
At April 4, 2014	$(672)	$(350)	$16,134	$15,112	$505	$15,617
Unrealized gain on cash flow hedges	—	18	—	18	(6)	12
Realized loss on foreign currency hedges	—	8	—	8	(3)	5
Realized loss on interest rate swap hedges	—	106	—	106	(37)	69
Foreign currency translation loss	—	—	(393)	(393)	—	(393)
At July 4, 2014	$(672)	$(218)	$15,741	$14,851	$459	$15,310

	Defined Benefit Plan Liability	Cash Flow Hedges	Foreign Currency Translation Adjustment	Total Pre-Tax Amount	Tax	Net-of-Tax Amount
At January 3, 2014	$(672)	$(468)	$14,952	$13,812	$546	$14,358
Unrealized gain on cash flow hedges	—	168	—	168	(59)	109
Realized gain on foreign currency hedges	—	(156)	—	(156)	55	(101)
Realized loss on interest rate swap hedges	—	238	—	238	(83)	155
Foreign currency translation gain	—	—	789	789	—	789

At July 4, 2014	$(672)	$(218)	$15,741	$14,851	$459	$15,310

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

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

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. 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, the Company received 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 $1.5 million is expected to be realized within the next twelve months.

Interest Rate Swaps – The fair value of the Company's interest rate swaps outstanding at July 3, 2015 were 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, 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 swaps will be realized as Interest Expense as interest on the Credit Facility is accrued.

The following table provides information regarding liabilities recorded at fair value on a recurring basis (in thousands):

		Fair Value Measurements Using		
Description	At July 3, 2015	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Liabilities				
Foreign currency contracts (Note 11)	$2,036	$—	$2,036	$—
Interest rate swap (Note 6)	1,583	—	1,583	—

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Fair value standards also apply to certain assets and liabilities that are measured at fair value on a nonrecurring basis. The carrying amounts of cash, accounts receivable, accounts payable, accrued expenses, and current portion of long-term debt approximate fair value because of the short-term nature of these items. As of July 3, 2015, the fair value of the Company's variable rate long-term debt approximates its carrying value and is categorized in Level 2 of the fair value hierarchy. A summary of the valuation methodologies for 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; 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, more likely than not, a 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.

Potential recoverability is measured by comparing the carrying amount of the 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. When it is

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

determined that useful lives are shorter than originally estimated, and no impairment is present, the rate of depreciation is accelerated in order to fully depreciate the assets over their new shorter useful lives. The Company did not record any impairment charges related to its long-lived assets during the first six months of 2015 or 2014.

Goodwill and Indefinite-lived Intangible Assets – Goodwill and other indefinite lived intangible assets recorded are not amortized but are periodically tested for impairment. The Company assesses goodwill for impairment on the last day of each fiscal year, or more frequently if certain events occur as described above. Goodwill is evaluated for impairment through the comparison of the fair value of the reporting units to their carrying values. When evaluating goodwill for impairment, the Company may first perform an assessment of qualitative factors to determine if the fair value of the reporting unit is more-likely-than-not greater than its carrying amount. This qualitative assessment is referred to as a “step zero” approach. If, based on the review of the qualitative factors, the Company determines it is more-likely-than-not that the fair value of the reporting unit is greater than its carrying value, the required two-step impairment test can be bypassed. If the Company does not perform a step zero assessment or if the fair value of the reporting unit is more-likely-than-not less than its carrying value, the Company must perform a two-step impairment test, and calculate the estimated fair value of the reporting unit. If, based upon the two-step impairment test, it is determined that 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. Under the two-step approach, fair values for reporting units are determined based on discounted cash flows and market multiples.

Other indefinite lived intangible assets are assessed for impairment on the last day of each fiscal year, or more frequently if certain events occur as described above, by comparing the fair value of the intangible asset to its carrying value. The fair value is determined by using the income approach.

The Company did not record any impairment charges related to its indefinite-lived intangible assets, including goodwill, during the first six months of 2015 or 2014, respectively. See Note 5 “Intangible Assets” for 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, which 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 July 3, 2015 and January 2, 2015 was $19.5 million and $14.5 million, respectively. The Company’s equity method investment is in a Chinese venture capital fund focused on investing in life sciences companies. This fund accounts for its investments at fair value with the unrealized change in fair value of these investments recorded as income or loss to the fund in the period of change. As of July 3, 2015, the Company owned 7.3% of this fund.

During the six month period ending July 3, 2015 and July 4, 2014, the Company did not recognize any impairment charges related to its cost method investments. The fair value of these investments is determined by reference to recent sales data of similar shares to independent parties in an inactive market. This fair calculation is categorized in Level 2 of the fair value hierarchy. During the six month period ending July 3, 2015 and July 4, 2014, the Company recognized a net gain on equity method investments of $0.5 million and $0.8 million, respectively.

15. BUSINESS SEGMENT, GEOGRAPHIC AND CONCENTRATION RISK INFORMATION

The Company has two reportable segments: Greatbatch Medical and QiG. Greatbatch Medical designs and manufactures medical devices and components where Greatbatch either owns the intellectual property or has unique manufacturing and assembly expertise. Greatbatch Medical provides medical devices and components to the following markets:

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Cardiac/Neuromodulation: Products include complete implantable medical devices and components such as batteries, capacitors, filtered and unfiltered feed-throughs, engineered components, implantable stimulation leads, and enclosures.

- Orthopaedic: Products include implants, instruments and delivery systems for large joint, spine, extremity and trauma procedures.
- Portable Medical: Products include automated external defibrillators, portable oxygen concentrators, ventilators, and powered surgical tools.

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- Vascular: Products include introducers, steerable sheaths, and catheters that deliver therapies for various markets such as coronary and neurovascular disease, peripheral vascular disease, interventional radiology, vascular access, atrial fibrillation, and interventional cardiology, plus products for medical imaging and pharmaceutical delivery.
- Energy, Military, and Environmental: Products include primary and rechargeable batteries and battery packs for demanding applications such as down hole drilling tools.

Greatbatch Medical also offers value-added assembly and design engineering services for medical devices that utilize its component products.

QiG is a medical device company formed in 2008 to develop and commercialize a neurostimulation technology platform for treatment of various disorders by stimulating tissues associated with the nervous system. QiG facilitates this development through the establishment of limited liability companies ("LLCs"). These LLCs do not own, but have the exclusive right to use the technology of Greatbatch in certain, specific fields of use and have an exclusive manufacturing agreement with Greatbatch Medical. QiG currently owns 89% of two LLCs - Algostim, LLC ("Algostim") and PelviStim LLC ("PelviStim"). Minority interests in these LLCs are held by key opinion leaders and clinicians. Under the agreements governing these LLCs, QiG funds 100% of the expenses incurred by the LLC. No distributions are made to the minority holders until QiG is reimbursed for these expenses. Once QiG has been fully reimbursed, any potential future distributions will be applied first to return contributions made by minority partners and thereafter will be made pro rata based upon ownership percentages.

Algostim is focused on the development and commercialization of its Algovita spinal cord stimulation ("SCS") system ("Algovita"), the first application of QiG's neurostimulation technology platform. Algovita is indicated for the treatment of chronic pain of the trunk and limbs. Algovita was submitted for premarket approval ("PMA") to the United States Food & Drug Administration ("FDA") in December 2013 and in January 2014 documentation for European CE Mark was submitted to the notified body, TÜV SÜD America. CE Mark approval was obtained on June 17, 2014. In April 2015, the Company announced receipt of a letter from the FDA informing it that its PMA application for Algovita is approvable subject to completion of an FDA inspection that finds that the manufacturing facilities, methods and controls used in the production of Algovita comply with the applicable requirements of the FDA's Quality System Regulation. QiG expects to obtain final approval of its PMA application for Algovita during the second half of 2015 and to launch Algovita commercially in the United States shortly thereafter.

QiG is also in the process of developing additional applications for its neurostimulation technology platform for other emerging indications such as sacral nerve stimulation ("SNS"), and deep brain stimulation ("DBS"), among others. QiG's PelviStim subsidiary is focused on the commercialization of QiG's neurostimulation technology platform for SNS.

QiG revenue includes sales of neural interface technology, components and systems to the neuroscience and clinical markets from NeuroNexus, and a limited release of Algovita in Europe. As further discussed in Note 2 "Acquisition," in August 2014, the Company acquired CCC, a neuromodulation medical device developer and manufacturer for development stage companies. As a result of this transaction, QiG revenue for 2015 also includes sales of various medical device products such as implantable pulse generators, programmer systems, battery chargers, patient wands and leads to medical device companies. Once the medical devices developed by CCC for development stage companies receives regulatory approval and reaches significant production levels, the responsibility for manufacturing these products may be transferred to Greatbatch Medical.

On July 30, 2015, Greatbatch announced a proposed spin-off of a portion of its QiG segment through a tax-free distribution of all of the shares of its QiG Group LLC subsidiary to the stockholders of Greatbatch on a pro rata basis. Immediately prior to completion of the Spin-off, QiG Group LLC will be converted into a corporation organized under the laws of Delaware and change its name to Nuvectra. The portion of the QiG segment being spun-off is expected to be comprised of QiG Group LLC and its subsidiaries: (i) Algostim, (ii) PelviStim, and (iii) Greatbatch's NeuroNexus subsidiary. Upon completion of the Spin-off, Nuvectra will be an independent, publicly-traded company and Greatbatch will not own any shares of Nuvectra common stock but will retain the operations of QiG not spun-off, which includes CCC. The total financial impact of the Spin-off on the Company's Condensed Consolidated Financial Statements cannot be determined at this time. However, if completed, deal related costs for the Spin-off are estimated

to be between $10 million to $12 million for 2015. Additionally, once completed, the Spin-off is expected to deliver Greatbatch improved financial performance through its long-term manufacturing agreement with Nuvectra for the supply of Algovita and lower operating expenses estimated in the range of $12 million to $16 million on an annualized basis.

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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 where the products are shipped to (in thousands):

	Three Months Ended		Six Months Ended	
	July 3, 2015	July 4, 2014	July 3, 2015	July 4, 2014
Sales:				
Greatbatch Medical				
Cardiac/Neuromodulation	$90,153	$80,005	$166,426	$166,785
Orthopaedic	35,481	37,865	74,452	74,296
Portable Medical	17,700	16,737	31,367	35,940
Vascular	12,907	15,257	23,263	28,307
Energy, Military, Environmental	16,545	21,352	34,255	39,483
Total Greatbatch Medical	172,786	171,216	329,763	344,811
QiG	2,741	865	7,788	1,551
Elimination of Intersegment Sales[(a)]	(637)	—	(1,341)	—
Total sales	$174,890	$172,081	$336,210	$346,362

(a) Intersegment sales between Greatbatch Medical and QiG are eliminated in consolidation and are included in Greatbatch Medical's cardiac and neuromodulation product line.

	Three Months Ended		Six Months Ended	
	July 3, 2015	July 4, 2014	July 3, 2015	July 4, 2014
Segment income (loss) from operations:				
Greatbatch Medical	$28,914	$32,439	$50,667	$67,567
QiG	(7,002)	(6,173)	(12,452)	(12,086)
Total segment income from operations	21,912	26,266	38,215	55,481
Unallocated operating expenses	(8,878)	(6,727)	(15,792)	(13,418)
Operating income as reported	13,034	19,539	22,423	42,063
Unallocated other expense	(1,099)	(1,407)	(668)	(1,870)
Income before provision for income taxes	$11,935	$18,132	$21,755	$40,193

	Three Months Ended		Six Months Ended	
	July 3, 2015	July 4, 2014	July 3, 2015	July 4, 2014
Sales by geographic area:				
United States	$75,041	$77,761	$145,557	$158,873
Non-Domestic locations:				
Puerto Rico	37,415	31,885	71,431	66,483
Belgium	16,018	17,650	33,385	33,629
Rest of world	46,416	44,785	85,837	87,377
Total sales	$174,890	$172,081	$336,210	$346,362

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

	Three Months Ended		Six Months Ended	
	July 3, 2015	July 4, 2014	July 3, 2015	July 4, 2014
Customer A	20%	17%	21%	19%
Customer B	18%	17%	18%	16%
Customer C	12%	12%	13%	12%
Total	50%	46%	52%	47%

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

	As of	
	July 3, 2015	January 2, 2015
United States	$111,503	$113,851
Rest of world	41,210	31,074
Total	$152,713	$144,925

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 ("SEC"), Emerging Issues Task Force ("EITF"), 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.

In July 2015, the FASB issued Accounting Standards Update ("ASU") No. 2015-11, "Simplifying the Measurement of Inventory," which simplifies the subsequent measurement of inventory by requiring inventory to be measured at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. This ASU is effective for public business entities for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. The Company is currently assessing the impact of adopting this ASU on its Condensed Consolidated Financial Statements.

In April 2015, the FASB issued ASU No. 2015-03, "Interest-Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs," which changes the presentation of debt issuance costs in the financial statements. Under this ASU, the Company will present debt issuance costs in the balance sheet as a direct deduction from the related debt liability rather than as an asset. The guidance in this ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. The Company will apply the new guidance retrospectively to all prior periods presented beginning in the first quarter of fiscal year 2016. As disclosed in Note 6 "Debt," as of July 3, 2015, the Company had $2.7 million of debt related deferred financing costs recorded within Other Assets in the Condensed Consolidated Balance Sheet, which will be reclassified as a deduction from Long-Term Debt upon adoption of this ASU.

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers." The core principle behind ASU 2014-09 is that an entity should recognize revenue in an amount that reflects the consideration to which the entity expects to be entitled in exchange for delivering goods and services. This model involves a five-step process that includes identifying the contract with the customer, identifying the performance obligations in the contract, determining the transaction price, allocating the transaction price to the performance obligations in the contract and recognizing revenue when the entity satisfies the performance obligations. This ASU will supersede existing revenue recognition guidance. In July 2015, the FASB deferred for one year the effective date of the new standard to be effective for annual reporting periods beginning after December 15, 2017. Early application is permitted for all entities, but not before the original public entity effective date. This ASU allows two methods of adoption; a full retrospective approach where three years of financial information are presented in accordance with the new standard, and a modified retrospective approach where this ASU is applied to the most current period presented in the financial statements. The Company is currently assessing the financial impact of adopting the new standard and the methods of adoption; however, given the scope of the new standard, the company is currently unable to provide a reasonable estimate regarding the financial impact or which method of adoption will be elected.

In April 2014, the FASB issued ASU No. 2014-08, "Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity," which amends the definition of a discontinued operation and requires entities to provide additional disclosures about disposal transactions that do not meet the discontinued operations criteria. The revised

guidance changes how entities identify and disclose information about disposal transactions under U.S. GAAP. This ASU is effective prospectively for all disposals (except disposals classified as held for sale before the adoption date) or components initially classified as held for sale in periods beginning on or after December 15, 2014, with early adoption permitted. This ASU is applicable for disposal transactions, if any, that the Company enters into after January 2, 2015. This ASU did not materially impact the Company's Condensed Consolidated Financial Statements.

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

Our Business

We have two reportable segments: Greatbatch Medical and QiG Group ("QiG"). Greatbatch Medical designs and manufactures products where Greatbatch either owns the intellectual property or has unique manufacturing and assembly expertise. These products include medical devices and components for the cardiac, neuromodulation, orthopaedics, portable medical, vascular, and energy markets among others. Our Greatbatch Medical segment also offers value-added assembly and design engineering services for medical devices that utilize its component products. QiG is a medical device company formed in 2008 to develop and commercialize a neurostimulation technology platform for treatment of various disorders by stimulating tissues associated with the nervous system. QiG is in the process of developing applications for its neurostimulation technology platform for emerging indications such as spinal cord stimulation ("SCS"), sacral nerve stimulation ("SNS"), and deep brain stimulation ("DBS"), among others. QiG's Algostim, LLC ("Algostim") subsidiary is focused on the development and commercialization of its Algovita SCS system ("Algovita"), the first application of its neurostimulation technology platform and is indicated for the treatment of chronic pain of the trunk and limbs. QiG's PelviStim LLC ("PelviStim") subsidiary is focused on the commercialization of QiG's neurostimulation technology platform for SNS. QiG revenue includes sales of neural interface technology, components and systems to the neuroscience and clinical markets from Greatbatch's NeuroNexus Technologies, Inc. ("NeuroNexus") subsidiary. Our QiG segment also includes the results of Centro de Construcción de Cardioestimuladores del Uruguay ("CCC"), a neuromodulation medical device developer and manufacturer for development stage companies acquired by Greatbatch in August 2014.

On July 30, 2015, we announced a proposed spin-off of a portion of our QiG segment through a tax-free distribution of all of the shares of our QiG Group LLC subsidiary to the stockholders of Greatbatch on a pro rata basis (the "Spin-off"). Immediately prior to completion of the Spin-off, QiG Group LLC will be converted into a corporation organized under the laws of Delaware and change its name to Nuvectra Corporation ("Nuvectra"). The portion of the QiG segment being spun-off is expected to be comprised of QiG Group LLC and its subsidiaries: (i) Algostim, (ii) PelviStim, and (iii) Greatbatch's NeuroNexus subsidiary. Upon completion of the Spin-off, Nuvectra will be an independent, publicly-traded company and Greatbatch will not own any shares of Nuvectra common stock but will retain the operations of QiG not spun-off, which includes CCC.

Our Acquisition

On August 12, 2014, we purchased all of the outstanding common stock of CCC, headquartered in Montevideo, Uruguay. CCC is an active implantable neuromodulation medical device systems developer and manufacturer that produces a range of medical devices including implantable pulse generators, programmer systems, battery chargers, patient wands, and leads. This acquisition allows us to more broadly partner with medical device companies, complements our core discrete technology offerings, and enhances our medical device innovation efforts. The operating results of CCC were included in our QiG segment from the date of acquisition. Once the medical devices developed by CCC for development stage companies receives regulatory approval and reaches significant production levels, the responsibility for manufacturing these products may be transferred to Greatbatch Medical. The aggregate purchase price of CCC was $19.8 million, which we funded with cash on hand. Total assets acquired from CCC were $26.2 million. Total liabilities assumed from CCC were $6.4 million.

Going forward, we will continue to pursue acquisitions to enhance our top and bottom line growth trajectory, and expand our pipeline technologies. We have a healthy pipeline of targeted acquisitions that will strengthen our competitive positions and accelerate our growth. Our strategic criteria for these acquisitions is that they should drive expansion in our core markets, allow us to enter adjacent growth markets, are focused on proprietary technology, can be tightly integrated into our operating base, and will enhance our return on invested capital.

Our Customers

Our products are designed to provide reliable, long-lasting solutions that meet the evolving requirements and needs of our customers. The nature and extent of our selling relationships with each customer is different in terms of breadth of products purchased, purchased product volumes, length of contractual commitment, ordering patterns, inventory management and selling prices.

Our Greatbatch Medical customers include large multi-national original equipment manufacturers (“OEMs”), such as Biotronik, Biomet, Boston Scientific, Cyberonics, Halliburton Company, Johnson & Johnson, Medtronic, Philips Healthcare, Smith & Nephew, Sorin Group, St. Jude Medical, Stryker, Zimmer, and Zoll. For the six months ended July 3, 2015, Johnson & Johnson, Medtronic, and St. Jude Medical collectively accounted for 52% of our total sales. QiG customers include numerous scientists, hospitals, and universities throughout the world. Additionally, with the acquisition of CCC, QiG customers also include various research companies and institutes and early stage medical device companies.

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Financial Overview

Sales for the second quarter and first six months of 2015 increased 2% and decreased 3%, respectively, in comparison to the prior year period. Sales for the second quarter and first six months of 2015 include $1.2 million and $5.1 million, respectively, from CCC, which was acquired in August 2014. Sales for the second quarter and first six months of 2015 also include the impact of foreign currency exchange rate fluctuations, which reduced sales by approximately $5.5 million and $9.5 million, respectively, in comparison to the prior year period due to the strengthening dollar versus the Euro. Excluding the impact of these items, our organic constant currency sales increased 4% and decreased 2% for the second quarter and first six months of 2015 in comparison to the prior year, respectively. The second quarter 2015 organic constant currency sales increase was primarily due to record sales in our cardiac and neuromodulation product line of $90.2 million, as well as continued strength in our orthopaedics product line, which increased 8% on an organic constant currency basis over the prior year second quarter. Additionally, as expected, our portable medical product line stabilized during the quarter, increasing 6% over the prior year second quarter. Partially offsetting these increases was a $2.4 million and $4.8 million decrease in our vascular and energy, military and environmental ("EME") product lines, respectively, due to the tough comparable versus the prior year second quarter and a slowdown in the energy markets, respectively. Our organic constant currency decrease in sales for the first six months of 2015 was primarily due to weakness in our portable medical, vascular and EME product lines partially offset by strength in our orthopaedics product line.

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 earnings releases and investor presentations adjusted operating income and margin, adjusted net income, adjusted earnings per diluted share, and organic constant currency growth rates. These adjusted amounts, other than organic constant currency growth rates, 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) charges in connection with corporate realignments or a reduction in force (v) material litigation expenses, charges and gains, (vi) unusual or infrequently occurring items, (vii) gain/loss on the sale of investments, (viii) the income tax (benefit) related to these adjustments and (ix) certain tax items related to the Federal research and development tax credit which are outside the normal benefit received. Adjusted earnings per diluted share were calculated by dividing adjusted net income by adjusted diluted weighted average shares outstanding. To calculate organic constant currency growth rates, which excludes the impact of changes in foreign currency exchange rates, as well as the impact of any acquisitions or divestitures of product lines on sales growth rates, we convert current period sales from local currency to U.S. dollars using the previous period's foreign currency exchange rates and exclude the amount of sales acquired/divested during the period from the current/previous period amounts, respectively. We believe that the presentation of adjusted operating income and margin, adjusted net income, adjusted diluted earnings per share, and organic constant currency growth rates provides important supplemental information to management and investors seeking to understand the financial and business trends relating to our financial condition and results of operations. These measures are used by management to forecast and evaluate the operational performance of the Company. Additionally, incentive compensation targets for all of our associates are based upon adjusted operating income.

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

	Three Months Ended							
	Greatbatch Medical		QiG		Unallocated		Total	
	July 3, 2015	July 4, 2014	July 3, 2015	July 4, 2014	July 3, 2015	July 4, 2014	July 3, 2015	July 4, 2014
Sales	$172,786	$171,216	$2,741	$865	$(637)	$—	$174,890	$172,081
Operating income (loss) as reported	$28,914	$32,439	$(7,002)	$(6,173)	$(8,878)	$(6,727)	$13,034	$19,539

Adjustments:								
IP related litigation (SG&A)[a]	—	—	—	—	1,459	388	1,459	388
Consolidation and optimization (income) expenses	6,532	3,342	37	38	—	(5)	6,569	3,375
Acquisition and integration (income) expenses	8	30	53	(173)	37	190	98	47
Asset dispositions, severance and other	106	3	(3)	—	980	836	1,083	839
Adjusted operating income (loss)	$35,560	$35,814	$(6,915)	$(6,308)	$(6,402)	$(5,318)	$22,243	$24,188
Adjusted operating margin	20.6%	20.9%	NA	NA	NA	NA	12.7%	14.1%

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	Six Months Ended							
	Greatbatch Medical		QiG		Unallocated		Total	
	July 3, 2015	July 4, 2014	July 3, 2015	July 4, 2014	July 3, 2015	July 4, 2014	July 3, 2015	July 4, 2014
Sales	$329,763	$344,811	$7,788	$1,551	$(1,341)	$—	$336,210	$346,362
Operating income (loss) as reported	$50,667	$67,567	$(12,452)	$(12,086)	$(15,792)	$(13,418)	$22,423	$42,063
Adjustments:								
IP related litigation (SG&A)[(a)]	—	—	—	—	2,159	762	2,159	762
Consolidation and optimization expenses	13,303	2,920	426	66	—	232	13,729	3,218
Acquisition and integration (income) expenses	8	30	97	(603)	59	192	164	(381)
Asset dispositions, severance and other	222	(7)	(3)	—	1,493	1,217	1,712	1,210
Adjusted operating income (loss)	$64,200	$70,510	$(11,932)	$(12,623)	$(12,081)	$(11,015)	$40,187	$46,872
Adjusted operating margin	19.5%	20.4%	NA	NA	NA	NA	12.0%	13.5%

(a) In 2013, we filed suit against one of our cardiac/neuromodulation competitors alleging they were infringing on our intellectual property. Given the complexity and significant costs incurred pursuing this litigation, this quarter we began excluding these litigation expenses from adjusted amounts. Total costs expected to be incurred in connection with this litigation in 2015 is between $4 million and $5 million. We expect this litigation to proceed to trial during the first quarter of 2016. Prior period adjusted amounts have been recalculated to exclude these costs for all periods.

GAAP operating income for the second quarter and first six months of 2015 decreased 33% and 47%, respectively. Adjusted operating income, which excludes material intellectual property ("IP") related litigation expenses, as well as other operating expenses, net decreased 8% and 14%, respectively. These GAAP and adjusted operating income variances are primarily due to the following:

Second Quarter 2015

- Gross profit of $58.0 million was consistent with the $58.5 million earned in the prior year period as the benefit of higher sales volumes was offset by continued pricing pressure from our customers. As a result, our gross profit as a percentage of sales decreased 90 basis points to 33.1% in comparison to the second quarter of 2014;
- A $2.2 million, or 10%, increase in selling, general, and administrative ("SG&A") expenses was partially attributable to the acquisition of CCC, which added $0.3 million of SG&A costs, as well as higher legal fees in connection with IP related litigation of $1.1 million, which are excluded from adjusted amounts. Additionally, our QiG medical device business, excluding CCC, accounted for $0.5 million of this increase as we continue to invest resources in connection with the commercialization of Algovita; and
- The decrease in GAAP operating income was also attributable to a $3.9 million increase in costs incurred in connection with our 2014 initiatives to invest in capacity and capabilities, which are included in other operating expenses, net and are excluded from adjusted amounts.

First Six Months 2015

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A $5.7 million, or 5%, decrease in gross profit driven primarily as a result of lower sales volumes. Additionally, in comparison to the prior year first half, gross profit as a percentage of sales decreased 70 basis points due to pricing pressure from our customers;

- A $3.1 million, or 7%, increase in SG&A expenses partially attributable to the acquisition of CCC, which added $1.0 million of SG&A costs, as well as higher legal fees in connection with IP related litigation of $1.4 million, which are excluded from adjusted amounts. Additionally, our QiG medical device business, excluding CCC, accounted for $1.2 million of this increase as we continue to invest resources in connection with the commercialization of Algovita; and
- The decrease in GAAP operating income was also attributable to a $10.5 million increase in costs incurred in connection with our 2014 initiatives to invest in capacity and capabilities, which are included in other operating expenses, net and are excluded from adjusted amounts.

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

	Three Months Ended				Six Months Ended			
	July 3, 2015		July 4, 2014		July 3, 2015		July 4, 2014	
	Net Income	Per Diluted Share	Net Income	Per Diluted Share	Net Income	Per Diluted Share	Net Income	Per Diluted Share
Net income as reported	$9,283	$0.35	$12,348	$0.48	$17,291	$0.66	$27,270	$1.06
Adjustments:								
IP related litigation (SG&A)[a]	948	0.04	252	0.01	1,403	0.05	495	0.02
Consolidation and optimization expenses[a]	5,361	0.20	2,181	0.08	10,899	0.41	1,255	0.05
Acquisition and integration (income) expenses[a]	70	—	31	—	116	—	(248)	(0.01)
Asset dispositions, severance and other[a]	698	0.03	545	0.02	1,132	0.04	787	0.03
(Gain) loss on cost and equity method investments, net[a][b]	(27)	—	27	—	(351)	(0.01)	(507)	(0.02)
R&D Tax Credit[c]	400	0.02	400	0.02	800	0.03	800	0.03
Adjusted net income and diluted EPS[d]	$16,733	$0.64	$15,784	$0.61	$31,290	$1.19	$29,852	$1.16
Adjusted diluted weighted average shares	26,313		25,901		26,264		25,823	

(a) Net of tax amounts computed using a 35% U.S., Mexico, and France statutory tax rate, a 25% Uruguay statutory tax rate, and a 0% tax rate for Swiss adjustments.

(b) Pre-tax amount is a gain of $42 thousand and $540 thousand for the 2015 second quarter and year-to-date periods, respectively, and a loss of $42 thousand and gain of $780 thousand for the 2014 second quarter and year-to-date periods, respectively.

(c) The Federal R&D tax credit has not yet been extended for 2015. The 2014 Federal R&D tax credit was enacted in the fourth quarter of 2014. Amounts assume that the tax credit was effective at the beginning of the year for 2015 and 2014.

(d) The per share data in this table has been rounded to the nearest $0.01 and therefore may not sum to the total.

GAAP and adjusted diluted EPS for the second quarter of 2015 were $0.35 and $0.64, respectively, compared to $0.48 and $0.61 for the second quarter of 2014. For the first six months of 2015, GAAP and adjusted diluted EPS were $0.66 and $1.19, respectively, compared to $1.06 and $1.16, respectively, for the same period of 2014. These variances were primarily due to the same factors impacting GAAP and adjusted operating income discussed above, as well as the following:

- During the second quarter and first six months of 2015, foreign currency exchange gains increased $0.4 million and $1.6 million, respectively, in comparison to the prior year primarily due to the strengthening of the U.S. dollar relative to the Euro;
- The changes in the GAAP and adjusted effective tax rates between second quarter and first six months of 2015 in comparison to the same periods of 2014 were primarily due to $0.2 million and $1.0 million, respectively, of discrete tax items recognized during the 2015 periods due to the settlement of tax audits, as well as higher income in lower tax rate jurisdictions in 2015 versus 2014; and
- An increase in weighted average diluted shares outstanding for the second quarter and first six months of 2015 versus the same periods of 2014 as a result of the increase in our stock price and stock issued under our stock-based compensation programs during those respective periods. This increase reduced the 2015 second quarter and year-to-date GAAP diluted EPS by $0.01 and $0.01, respectively, and adjusted diluted EPS by $0.01 and $0.02, respectively.

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Financial Guidance

Our guidance for fiscal year 2015 is as follows:	
Sales	$715 - $730 million
GAAP Operating Income as a % of Sales	7.5% - 8.5%
Adjusted Operating Income as a % of Sales	13.7% - 14.0%
Capital Expenditures	$40 - $50 million
GAAP Effective Tax Rate	~23.5%
Adjusted Effective Tax Rate	~21% - 24%
GAAP Diluted EPS	$1.43 - $1.53
Adjusted Diluted EPS	$2.61 - $2.71
Diluted Weighted Average Shares	26,500,000

Currency translation is expected to have a negative impact of approximately $14 million on 2015 sales. As a result, we are expecting to be at the lower end of our revenue guidance range.

Adjusted operating income for 2015 is expected to consist of GAAP operating income excluding items such as deal-related Spin-off costs ($10 million to $12 million), acquisition, consolidation, integration and asset disposition/write-down charges ($23 million) totaling approximately $35 million, as well as approximately $4.5 million of IP related litigation SG&A expenses. The after tax impact of these items is estimated to be approximately $30 million or approximately $1.12 per diluted share. Adjusted diluted EPS also includes the benefit of the Federal research and development tax credit of approximately $1.6 million or $0.06 per diluted share, which has not yet been enacted for 2015.

We continue to expect that we will Spin-off Nuvectra before year-end. Our guidance includes expected Nuvectra results through the end of the year. Once completed, the Spin-off is expected to deliver Greatbatch improved financial performance through our long-term manufacturing agreement with Nuvectra for the supply of Algovita and lower operating expenses estimated in the range of $12 million to $16 million on an annualized basis.

Our CEO’s View

We are very satisfied with our results for the second quarter, which were consistent with our expectations. During the quarter we continued to drive the implementation of our strategic plan with investments in technology, capacity and capabilities. We expect to finish the year strong based upon new and existing customer business pipelines and carry this momentum into 2016. On July 30, 2015, we filed an initial Form 10 registration statement with the U.S. Securities and Exchange Commission (“SEC”) for our proposed spin-off of our neuromodulation subsidiary, QiG Group LLC, to be named Nuvectra. Nuvectra will be initially focused on the development and commercialization of Algovita, the first application of its neurostimulation technology platform.

The strategic spin-off of Nuvectra will provide both entities the focus and flexibility needed to execute their growth initiatives, distinct strategies and provide their respective customers with unparalleled service. Furthermore, it will allow each company to better allocate resources to meet the needs of their respective businesses, pursue distinct capital allocation strategies and focus on targeted growth opportunities with a clear investment proposition to attract long-term investors best suited to each company. The filing of our initial Form 10 was an important step in the process of spinning-off Nuvectra. Once completed, the Spin-off is expected to deliver improved shareholder returns through the Nuvectra Spin-off share dividend, reduction of $12 million to $16 million in operating expenses (annualized basis)

and through a long-term manufacturing agreement with Nuvectra for the supply of Algovita. This allows Greatbatch to continue its strategic investment in all of Greatbatch's markets including the neuromodulation market.

Product Development
Greatbatch Medical
Our core business is well positioned because our OEM customers leverage our portfolio of intellectual property, and we continue to build a healthy pipeline of diverse medical technology opportunities. These product development opportunities, when combined with the investments we have made in our sales and marketing resources, are expected to allow us to meet our

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five percent revenue growth objectives. Some of the more significant product development opportunities Greatbatch Medical is pursuing are as follows:

Product Line	Product Development Opportunities
Cardiac/ Neuromodulation	Developing next generation technology programs including Gen 2 Q_{HR} battery, next generation filtered feedthroughs, and high voltage capacitors.
Orthopaedic	Developing next generation reamers, hip and bone preparation instruments, as well as disposable kits, and power solutions for surgical tools.
Portable Medical	Developing proprietary power solutions for various surgical, diagnostic and other market categories where device mobility is critical, including sterilized surgical products, wireless power and battery management technologies.
Vascular	Developing introducer technologies to expand into new clinical markets, as well as expanding current introducer and catheter platforms to better serve existing clinical markets and customers.
Energy, Military, Environmental	Developing power solutions to advance performance and reliability of battery packs in critical environments.

QiG

Through QiG, we provide our Greatbatch Medical customers with complete medical device systems. This medical device strategy includes strategic equity investments and medical device technology and products developed independently, as well as in conjunction with our OEM partners. While we do not intend to discuss each of these projects individually, we will discuss significant milestones as they occur.

Algovita, our SCS system to treat chronic intractable pain of the trunk and/or limbs, was designed to target unmet clinical needs with a focus on safety and product differentiation for all user groups. This product was submitted for premarket approval (“PMA”) to the United States Food & Drug Administration (“FDA”) in December 2013, and in January 2014 documentation for European CE Mark was submitted to the notified body, TÜV SÜD America. CE Mark approval was received in June 2014. In April 2015, we announced receipt of a letter from the FDA informing us that our PMA application for Algovita is approvable subject to completion of an FDA inspection that finds that the manufacturing facilities, methods and controls used in the production of Algovita comply with the applicable requirements of the FDA’s Quality System Regulation. We expect to obtain final approval of our PMA application for Algovita during the second half of 2015 and to launch Algovita commercially in the United States shortly thereafter.

QiG intends to modify the Algovita platform for other established indications in growing and emerging technologies such as SNS and DBS, among others. CCC will be used for early stage technologies. We have a large and growing list of interested partners in the space that we can engage. Additionally we are leveraging NeuroNexus and CCC for early stage research and development. Lastly, we will continue to advance and incorporate the capabilities from our core Greatbatch Medical segment across opportunities in neurostimulation.

Cost Savings and Consolidation Efforts

In 2015 and 2014, 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, the most significant of which are as follows (in millions):

Initiative	Expected Expense	Expected Capital	Expected Benefit to Operating Income[(a)]	Expected Completion Date
2014 investments in capacity and capabilities	$29 - $34	$25 - $28	> $20	2016
2013 operating unit realignment	$6.6	—	> $7	Completed
Orthopaedic optimization	$45 - $48	$30 - $35	$15 - $20	2011 - 2017

(a) Represents the annual benefit to our operating income expected to be realized from these initiatives through cost savings and/or increased capacity. These benefits will be phased in over time as the various initiatives are completed. See Note 9 “Other Operating Expenses, Net” of the Notes to the Condensed Consolidated Financial Statements contained in Item 1 of this report for additional information about the timing, cash flow impact and amount of future expenditures for these initiatives. We continually evaluate our operating structure in order to maximize efficiencies and drive margin expansion. Future charges could be incurred if new consolidation and optimization initiatives are undertaken.

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Our Financial Results

We utilize a fifty-two, fifty-three week fiscal year ending on the Friday nearest December 31. For 52-week years, each quarter contains 13 weeks. The second quarter and first six months of 2015 and 2014 ended on July 3, and July 4, respectively, and each contained 13 weeks and 26 weeks, respectively. The discussion 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 January 2, 2015. 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				Six Months Ended			
	July 3, 2015	July 4, 2014	Change $	Change %	July 3, 2015	July 4, 2014	Change $	Change %
Sales:								
Greatbatch Medical								
Cardiac/Neuromodulation	$90,153	$80,005	$10,148	13 %	$166,426	$166,785	$(359)	— %
Orthopaedic	35,481	37,865	(2,384)	(6)%	74,452	74,296	156	— %
Portable Medical	17,700	16,737	963	6 %	31,367	35,940	(4,573)	(13)%
Vascular	12,907	15,257	(2,350)	(15)%	23,263	28,307	(5,044)	(18)%
Energy, Military, Environmental	16,545	21,352	(4,807)	(23)%	34,255	39,483	(5,228)	(13)%
Total Greatbatch Medical	172,786	171,216	1,570	1 %	329,763	344,811	(15,048)	(4)%
QiG	2,741	865	1,876	217 %	7,788	1,551	6,237	402 %
Elimination of intersegment sales[(a)]	(637)	—	(637)	NA	(1,341)	—	(1,341)	NA
Total sales	174,890	172,081	2,809	2 %	336,210	346,362	(10,152)	(3)%
Cost of sales	116,939	113,611	3,328	3 %	225,861	230,296	(4,435)	(2)%
Gross profit	57,951	58,470	(519)	(1)%	110,349	116,066	(5,717)	(5)%
Gross profit as a % of sales	33.1 %	34.0 %			32.8 %	33.5 %		
Selling, general and administrative expenses (SG&A)	24,104	21,877	2,227	10 %	46,713	43,632	3,081	7 %
SG&A as a % of sales	13.8 %	12.7 %			13.9 %	12.6 %		
Research, development and engineering costs, net (RD&E)	13,063	12,793	270	2 %	25,608	26,324	(716)	(3)%
RD&E as a % of sales	7.5 %	7.4 %			7.6 %	7.6 %		
Other operating expenses, net	7,750	4,261	3,489	82 %	15,605	4,047	11,558	286 %
Operating income	13,034	19,539	(6,505)	(33)%	22,423	42,063	(19,640)	(47)%
Operating margin	7.5 %	11.4 %			6.7 %	12.1 %		
Interest expense	1,206	1,073	133	12 %	2,326	2,157	169	8 %
Other (income) expense, net	(107)	334	(441)	NA	(1,658)	(287)	(1,371)	478 %
Provision for income taxes	2,652	5,784	(3,132)	(54)%	4,464	12,923	(8,459)	(65)%
Effective tax rate	22.2 %	31.9 %			20.5 %	32.2 %		
Net income	$9,283	$12,348	$(3,065)	(25)%	$17,291	$27,270	$(9,979)	(37)%
Net margin	5.3 %	7.2 %			5.1 %	7.9 %		
Diluted earnings per share	$0.35	$0.48	$(0.13)	(27)%	$0.66	$1.06	$(0.40)	(38)%

(a) Intersegment sales between Greatbatch Medical and QiG are eliminated in consolidation and are included in Greatbatch Medical's cardiac and neuromodulation product line.

Greatbatch Medical Sales

Total Greatbatch Medical sales for the second quarter of 2015 increased 1% in comparison to the prior year period. However, for the first six months of 2015, Greatbatch Medical sales decreased 4% over the comparable 2014 period. The most significant contributors to these variances were as follows:

Cardiac and neuromodulation revenues for the second quarter of 2015 were a record $90.2 million and increased 13% in comparison to the prior year second quarter. This increase reflects the benefit of new product introductions, as well as the timing of customer inventory builds in comparison to the prior year. These increases were partially offset by the continued impact (approximately $1.5 million) of end of life products in our legacy cardiac product line. For the first six months of 2015, cardiac and neuromodulation sales were consistent with the prior year period as the impact of end of life products (approximately $6.5 million) was offset by the benefit of new product introductions, as well as the timing of customer

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inventory builds. Growth in our cardiac and neuromodulation product line for the next several quarters will continue to be negatively impacted by the end of life on legacy products, as well as continued pressure from our customer's cost reduction initiatives. We estimate that end of life products will reduce 2015 cardiac and neuromodulation revenue by approximately $10 million - $15 million in comparison to 2014. We expect we will be able to mitigate these headwinds as we have line-of-sight with new customers and new product introductions that are expected to provide strong performance in the second half of the year.

Orthopaedic sales for the second quarter and first six months of 2015 decreased 6% and remained consistent with the comparable 2014 periods, respectively. For the second quarter and first six months of 2015, foreign currency exchange rate fluctuations, which resulted from the strengthening of the U.S. dollar versus the Euro, decreased sales by approximately $5.5 million and $9.5 million, respectively, in comparison to the prior year periods. On an organic constant currency basis, in comparison to the prior year second quarter and year-to-date periods, our orthopaedic sales increased 8% and 13%, respectively, as we continued to benefit from market growth, new customer wins, and our investments in capacity and capabilities at our Chaumont, France facility. Foreign currency exchange rate fluctuations are expected to be a significant headwind for the remainder of the year and are expected to have a negative impact of approximately $14 million on 2015 orthopaedic sales. We anticipate orthopaedic revenue growth to be in the high single digit to low double digit range on an organic constant currency basis for 2015.

Portable medical sales for the second quarter of 2015 stabilized, increasing 6% in comparison to the prior year second quarter. However, portable medical sales for the first six months of 2015 decreased 13% in comparison to the first six months of 2014. We are refocusing our product line offerings in the portable medical space to products that have higher profitability. Correspondingly, we have discontinued or reduced volumes in certain of our lower margin products, which is expected to continue to negatively impact our sales through the second half of 2015. As part of our investment in capacity and capabilities and to better align our resources, during the second quarter of 2014, we announced plans to transfer our portable medical operations into a new facility located in Tijuana, Mexico. This transfer is progressing as planned with initial production from our new Tijuana facility slated for late fourth quarter 2015. During the current quarter, we renewed a contract with a major portable medical customer and expect to introduce proprietary power solutions to drive future organic growth in this product line.

Vascular sales for the second quarter and first six months of 2015 declined 15% and 18%, respectively, in comparison to the prior year periods. These decreases were primarily due to customer inventory management initiatives and tough comparables versus the prior year periods. We expect this product line to resume growth in the second half of the year as customers work off their excess inventory. Additionally, we believe that our manufacturing move to Mexico will position us to be competitive in both new and existing markets beginning in 2016 and beyond.

Second quarter and year-to-date 2015 EME sales declined 23% and 13%, respectively, in comparison to the prior year periods. These decreases were primarily due to the slowdown in the energy markets, which has caused customers to reduce drilling volumes and is expected to be a headwind for the remainder of the year.

QiG Sales

QiG revenue for the second quarter and first six months of 2015 increased $1.9 million and $6.2 million, respectively, in comparison to the prior year periods. Sales for the second quarter and first six months of 2015 include $1.2 million and $5.1 million, respectively, from CCC, which was acquired in August 2014. On an organic constant currency basis, 2015 second quarter and year-to-date QiG revenue increased $0.6 million and $1.1 million, respectively, due to new product launches including a limited release of Algovita in Europe and the NeuroNexus SmartBox™ portable control and data streaming system.

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		Six Months	
Performance-based compensation[(a)]	0.1	%	0.5	%
Production efficiencies, volume and mix[(b)]	0.8	%	0.7	%
Impact of acquisition[(c)]	(0.4	)%	(0.3	)%

Price[(d)]	(1.2	)%	(0.9	)%
Other	(0.2	)%	(0.7	)%
Total percentage point change to gross profit as a percentage of sales	(0.9	)%	(0.7	)%

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(a) Amount represents the change in performance-based compensation versus the prior year period and is recorded based upon the actual results achieved.

(b) Our gross profit percentage benefited from higher volumes and production efficiencies gained as a result of our investments in capacity and capabilities.

(c) Amounts represent the impact to our gross profit percentage related to the acquisition of CCC in August 2014.

(d) Our gross profit percentage was negatively impacted by continued pricing pressure from our larger OEM customers.

Over the long-term, we expect to see gross margin improvements as we leverage our organic growth across our manufacturing footprint and realize the benefit of the various productivity improvement initiatives that are being implemented (see “Cost Savings and Consolidation Efforts” section of this Item). Additionally, we expect our gross margin to improve as more system and device level products are introduced, which typically earn a higher margin.

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	Six Months
Performance-based compensation[(a)]	$(104)	$(1,434)
Legal fees[(b)]	946	1,337
G&A personnel costs[(c)]	893	1,635
Impact of acquisition[(d)]	288	1,005
Other	204	538
Net increase in SG&A	$2,227	$3,081

(a) Amount represents the change in performance-based compensation versus the prior year period and is recorded based upon actual results achieved.

(b) Amount represents the increase in legal costs compared to the prior year period and includes higher IP related defense costs, as well as other corporate initiatives. In 2013, we filed suit against one of our cardiac/neuromodulation competitors alleging they were infringing on our IP. Costs associated with this litigation accounted for $1.1 million and $1.4 million of the quarter and year-to-date increases in SG&A expenses, respectively, from 2014 to 2015. Total costs expected to be incurred in connection with this litigation in 2015 is between $4 million and $5 million. We expect this litigation to proceed to trial during the first quarter of 2016.

(c) Amount represents various increases in general and administrative costs related to the growth of our business. Our QiG medical device business, excluding CCC, accounted for $0.5 million and $1.2 million of this increase for the quarter and year-to-date periods, respectively, as we continue to invest resources in connection with the commercialization of Algovita.

(d) Amount represents the incremental SG&A expenses related to the acquisition of CCC in August 2014.

RD&E Expenses, Net

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

	Three Months Ended		Six Months Ended	
	July 3, 2015	July 4, 2014	July 3, 2015	July 4, 2014
Research, development and engineering costs	$15,273	$15,075	$29,103	$30,534
Less: cost reimbursements	(2,210)	(2,282)	(3,495)	(4,210)
Total RD&E, net	$13,063	$12,793	$25,608	$26,324

Net RD&E costs for the 2015 second quarter increased $0.3 million versus the comparable 2014 period and decreased $0.7 million for the year-to-date period. The increase for the second quarter was a result of higher performance-based compensation in comparison to the prior year period, which was accrued based upon the achievement of certain Algovita commercialization milestones. The decrease for the year-to-date period was primarily attributable to lower DVT costs incurred in connection with the development of Algovita as well as lower corporate-wide

performance-based compensation, which is recorded based upon actual results achieved.

The decrease in customer cost reimbursements for the first six months of 2015 primarily relates to the expiration of certain government grants acquired in our acquisition of NeuroNexus, which Greatbatch was not eligible to renew.

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Other Operating Expenses, Net

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

	Three Months Ended		Six Months Ended	
	July 3, 2015	July 4, 2014	July 3, 2015	July 4, 2014
2014 investments in capacity and capabilities[(a)]	$6,051	$2,166	$12,738	$2,218
Orthopaedic optimization costs[(a)]	518	1,187	991	36
2013 operating unit realignment[(a)]	—	32	—	1,035
Other consolidation and optimization income, net[(a)]	—	(10)	—	(71)
Acquisition and integration costs (income)[(b)]	98	47	164	(381)
Asset dispositions, severance and other[(c)]	1,083	839	1,712	1,210
Total other operating expenses (income), net	$7,750	$4,261	$15,605	$4,047

(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 2015 and 2014, we incurred costs (income) related to the integration of CCC and NeuroNexus. These expenses were primarily for travel costs in connection with integration efforts, consulting, training, and the change in fair value of the contingent consideration recorded in connection with the NeuroNexus acquisition, which resulted in a gain of $0.6 million during the first six months of 2014.

(c) During 2015 and 2014, we recorded losses in connection with various asset disposals. In addition, total legal and professional costs incurred in connection with the proposed Spin-off during the first six months of 2015 were $1.5 million ($1.0 million for the second quarter 2015). Expenses related to this initiative will be recorded within the applicable segment and corporate cost centers to which the expenditures relate. Refer to Note 15 "Business Segment, Geographic and Concentration Risk Information" of the Notes to the Condensed Consolidated Financial Statements contained in Item 1 of this report for additional discussion on the proposed Spin-off. During the first six months of 2014, the Company recorded $1.2 million of charges in connection with its business reorganization to align its contract manufacturing operations. Those costs primarily related to consulting and IT development projects, which were completed in the fourth quarter of 2014.

We continually evaluate our operating structure in order to maximize efficiencies and drive margin expansion. Other operating expenses, net for 2015 are expected to be approximately $35 million, as we continue to invest in our capacity and capabilities. This includes transaction-related costs related to the proposed Spin-off, which are estimated to be between $10 million to $12 million for 2015 if the proposed Spin-off is completed in 2015.

Interest Expense

Interest expense for the second quarter and first six months of 2015 were relatively consistent with the same periods of 2014.

Other (Income) Expense, Net

Other (income) expense, net primarily includes the impact of foreign currency exchange rate fluctuations on transactions denominated in foreign currencies. We recognized $0.2 million and $1.3 million of foreign currency exchange gains during the second quarter and first six months of 2015, respectively, compared to losses of $0.2 million and $0.3 for the same periods of 2014, primarily due to the strengthening of the U.S. dollar relative to the Euro. Additionally, income realized on our equity method investment increased $0.1 million and decreased $0.2 million for the second quarter and first six months of 2015, respectively, in comparison to prior year periods. We generally do not expect foreign currency exchange rate fluctuations to have a material impact on our results of operations.

As of July 3, 2015 and January 2, 2015 we held $19.5 million and $14.5 million, respectively, of investments in equity and other securities that are accounted for as either cost or equity method investments. The total carrying value of these investments is reviewed quarterly for changes in circumstance or the occurrence of events that suggest our investment may not be recoverable. These investments are in start-up research and development companies whose fair value is highly subjective in nature and could be subject to significant fluctuations in the future that could result in

material gains or losses.

Provision for Income Taxes

The 2015 second quarter GAAP effective tax rate was 22.2% compared to 31.9% for the same period of 2014. This decrease is primarily attributable to $0.2 million of favorable discrete tax items, as well as higher income in lower tax rate jurisdictions. The 2015 GAAP effective tax rate for the first six months of 2015 was 20.5% compared to 32.2% for the same period of 2014.

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This decrease is primarily attributable to $1.0 million of favorable discrete tax items due to the settlement of tax audits in the first quarter of 2015, as well as higher income in lower tax rate jurisdictions.

We currently expect our 2015 annual GAAP effective tax rates to be approximately 23.5%. This guidance does not include the benefit of the U.S. Federal R&D tax credit. If reinstated, our 2015 GAAP income tax provision would be lowered by approximately $1.6 million, but is already considered in our adjusted effective tax rate guidance for 2015 of approximately 21% to 24%.

We expect there to be 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. We currently have various tax planning initiatives in place that are aimed at reducing our effective tax rate over the long-term.

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. healthcare 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. The medical device tax, which was effective in 2013, increased our cost of sales by $0.3 million for the first six months of 2015.

In the first quarter of 2014, we initiated a voluntary field corrective action for all Standard Offset Cup Impactors after an internal review determined that the sterilization recommendation in the Instructions For Use for the product did not meet requirements for sterility assurance, which has the potential to result in surgical infection. We have validated two sterilization parameters that meet acceptable sterility assurance levels and provided them to affected customers. We have informed the FDA and other government agencies of this action, which impacts all Standard Offset Cup Impactors manufactured and distributed from 2004 to 2013. Greatbatch has received three complaints possibly related to this issue, however no adverse events have been reported. Future customer complaints or negative regulatory actions regarding this product or any of our products could harm our operating results or financial condition.

Liquidity and Capital Resources

	As of	
(Dollars in thousands)	July 3, 2015	January 2, 2015
Cash and cash equivalents	$72,338	$76,824
Working capital	$256,779	$242,022
Current ratio	3.60	3.23

The decrease in cash and cash equivalents from the end of 2014 was primarily due to our investment of $26.7 million in property, plant and equipment and cost method investments during the first two quarters partially offset by cash flow from operations of $22.5 million. The increase in our working capital and current ratio during the quarter was primarily a result of the cash generated by operations, which was used to build inventory and pay down accrued expenses. Of the $72.3 million of cash and cash equivalents on hand as of July 3, 2015, $16.1 million is being held at our foreign subsidiaries and is considered permanently reinvested.

Revolving Line of Credit – We have a credit facility (the “Credit Facility”), which consists of a $300 million revolving line of credit (the “Revolving Credit Facility”), a $182.5 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 an additional $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 to the lenders and subject to the satisfaction of 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 July 3, 2015, each bank supporting 98% of the Revolving Credit Facility each had an S&P credit rating of at least BBB or

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better, which is considered investment grade. The bank which supports the remaining 2% of the Revolving Credit Facility is not currently being rated.

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 July 3, 2015, our ratio of adjusted EBITDA to interest expense, calculated in accordance with our credit agreement, was 26.7 to 1.00, 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 decreasing to not greater than 4.25 to 1.0 after January 2, 2016. As of July 3, 2015, our total leverage ratio, calculated in accordance with our credit agreement, was 1.56 to 1.00, well below the required limit.

See Note 6 “Debt” of the Notes to the Condensed Consolidated Financial Statements contained in Item 1 of this report for a more detailed description of the Credit Facility.

As of July 3, 2015, we had $300 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 available borrowing capacity under the Credit Facility provide adequate liquidity to meet our short- and long-term funding needs.

Operating Activities – Cash provided by operations of $22.5 million decreased 15% for the first six months of 2015 versus the comparable 2014 period. This decrease was primarily due to lower cash net income in comparison to the prior year. Immediately prior to the completion of the proposed Spin-off, Greatbatch will make a cash capital contribution to Nuvectra, which is expected to help fund their operations for approximately two to three years. This amount has not yet been determined by our Board of Directors but is expected to be funded with cash on hand and/or availability under our Credit Facility.

Investing Activities – Net cash used in investing activities for the first six months of 2015 was $26.0 million compared to $9.8 million in the comparable 2014 period. This included $22.2 million of cash used in 2015 for the purchase of property, plant, and equipment in connection with the consolidation and optimization initiatives discussed in Note 9 “Other Operating Expenses, Net” of the Notes to the Condensed Consolidated Financial Statements contained in Item 1 of this report as well as routine capital expenditures. Our current expectation is that capital spending for 2015 will be in the range of $40 million to $50 million, of which half is discretionary in nature. We anticipate that cash on hand, cash flows from operations and available borrowing capacity 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. We have a healthy pipeline of targeted acquisitions that will strengthen our competitive positions and accelerate our growth.

Financing Activities – Net cash used in financing activities for the first six months of 2015 was $0.5 million compared to $0.8 million in the comparable 2014 period. The net cash outflow for the first two quarters of 2015 included $5.1 million of cash received from the exercise of stock options during the first six months of 2015, which was partially offset by $5.0 million of principal payments on long-term debt.

Capital Structure – As of July 3, 2015, our capital structure consisted of $182.5 million of debt outstanding on our Term Loan and 25.5 million shares of common stock outstanding. Additionally, we had $72.3 million in cash and cash equivalents, which we believe is sufficient to meet our short-term operating cash needs. If necessary, we currently have access to $300 million under our Revolving 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.

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”) or other authoritative accounting bodies to determine the potential impact they may have on our Condensed Consolidated Financial Statements. See Note 16 “Impact of Recently Issued Accounting Standards” of the Notes to the Condensed Consolidated Financial Statements

contained in Item 1 of this report for additional information about these recently issued accounting standards and their potential impact on our financial condition or results of operations.

Contractual Obligations

A table of our contractual obligations as of January 2, 2015 was included in Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” of our Annual Report on Form 10-K for the fiscal year ended January 2, 2015.

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There have been no significant changes to our contractual obligations during the six months ended July 3, 2015. See Note 11 “Commitments and Contingencies” of the Notes to the Condensed Consolidated Financial Statements contained in Item 1 of this report for further discussion on our contractual obligations.

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, and these statements are subject to known and unknown risks, uncertainties and assumptions. Forward-looking statements include statements relating to:

- future sales, expenses and profitability;
- future development and expected growth of our business and industry;
- our ability to execute our business model and our business strategy;
- our ability to identify trends within our industries 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,” “p “anticipates,” “believes,” “estimates,” “predicts,” “potential” or “continue” or “variations” or the negative of these terms or oth comparable terminology. These statements are only predictions. Actual events or results may differ materially from those stated or implied by these forward-looking statements. In evaluating these statements and our prospects, 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; product field actions or recalls; 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; the timing, progress and ultimate success of pending regulatory actions and approvals, including with respect to Algovita; risks associated with the proposed spin-off of Nuvectra including our ability to execute the Spin-off successfully, the timing and taxable nature of the Spin-off, and the performance of Nuvectra post Spin-off; our inability to obtain licenses to key technology; regulatory changes, including Health Care Reform, 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 and are described in Item 1A “Risk Factors” of the Company’s Annual Report on Form 10-K and in other periodic filings with the SEC. Except as required by applicable law, the Company assumes no obligation to update forward-looking statements in this report whether to reflect changed assumptions, the occurrence of unanticipated events or changes in future operating results, financial conditions or prospects, or otherwise.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Currency – We have foreign operations in France, Mexico, Switzerland and Uruguay, which expose the Company to foreign currency exchange rate fluctuations due to transactions denominated in Euros, Mexican pesos, Swiss francs and Uruguayan pesos, 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 six months ended July 3, 2015 decreased sales in comparison to the 2014 period by approximately $9.5 million.

In 2014, we entered into a forward contract to purchase 19.2 million Mexican pesos per month beginning in January 2015 through December 2015 at an exchange rate of $0.0734 per peso. In 2015, we entered into a forward contract to purchase an

additional 4.0 million Mexican pesos per month beginning in March 2015 through December 2015 at an exchange rate of $0.0656 and to purchase 19.2 million Mexican pesos per month beginning in January 2016 through December 2016 at an exchange rate of $0.0656. 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 2015 and 2016 and are being accounted for as cash flow hedges. As of July 3, 2015, these contracts had a negative fair value of $2.0 million.

The amount recorded during the six months ended July 3, 2015 and July 4, 2014 related to our forward contracts was an increase in Cost of Sales of $0.7 million and a reduction in Cost of Sales of $0.2 million, respectively. No portion of the change in fair value of our foreign currency exchange rate contracts during the six months ended July 3, 2015 or July 4, 2014 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 (Loss). The translation adjustment for the first six months of 2015 was a loss of $1.6 million and for the first six months of 2014 was a gain of $0.8 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 $1.3 million and a loss of $0.3 million for the first six months of 2015 and 2014, 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 $1.5 million on our foreign net assets as of July 3, 2015.

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 2012, we entered into a three-year $150 million interest rate swap, which amortizes $50 million per year beginning in 2014 and 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%. In 2014, we entered into an additional interest rate swap. The first $45 million of notional amount of the swap was effective February 20, 2015 and the second $45 million of notional amount is effective February 22, 2016. The notional amount of the swap amortizes $10 million per year beginning on February 21, 2017 with the remaining settled on the termination date of the swap agreement on September 20, 2019. Under the terms of the swap agreement, we pay a fixed interest rate of 1.921% and receive a floating interest rate equal to the one-month LIBOR rate.

These swaps were entered into in order to hedge against potential changes in cash flows on our outstanding variable-rate debt, which is also indexed to the one-month LIBOR rate. The receive variable leg of the interest rate swaps 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. These swaps are accounted for as cash flow hedges. As of July 3, 2015, these swaps had a negative fair value of $1.6 million.

As of July 3, 2015, we had $182.5 million outstanding under the Term Loan, of which $95 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 LIBOR rate on the $87.5 million of unhedged floating rate debt outstanding at July 3, 2015 would have an impact of approximately $0.9 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 Securities and Exchange Commission as of July 3, 2015. 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 our employees, and that this information is recorded, processed, summarized, evaluated and reported, as applicable, within the time periods specified in the Securities and Exchange Commission's rules and forms. Based on their evaluation, as of July 3, 2015, 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 acquired the following subsidiary during 2014:

Centro de Construcción de Cardioestimuladores del Uruguay

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We believe that the internal controls and procedures of the above mentioned subsidiary 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 this subsidiary 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 this subsidiary. However, the Company has excluded this subsidiary from management's assessment of the effectiveness of internal control over financial reporting as of January 2, 2015, as permitted by the guidance issued by the Office of the Chief Accountant of the Securities and Exchange Commission.

Other than as described above, there were no changes in the registrant's internal control over financial reporting 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.

PART II—OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

There were no new material legal proceedings that are required to be reported in the quarter ended July 3, 2015, and no material developments during the quarter in the Company's legal proceedings as previously disclosed in the Company's Annual Report on Form 10-K for the year ended January 2, 2015.

ITEM 1A. RISK FACTORS

On July 30, 2015, we announced our intentions to spin-off a portion of our QiG segment from the remainder of our business through a tax-free distribution of all of the shares QiG Group, LLC to the stockholders of Greatbatch on a pro rata basis (the "Spin-off"). Immediately prior to completion of the Spin-off, QiG Group LLC will be converted into a corporation organized under the laws of Delaware and change its name to Nuvectra Corporation ("Nuvectra"). We could be delayed or prevented from completing the proposed Spin-off, or be forced to complete it on terms or conditions that are less favorable and/or different than expected, for a variety of reasons, including unanticipated developments, such as delays in obtaining regulatory approvals for Algovita, uncertainty of the financial markets, or challenges in establishing infrastructure and processes. Even if the transaction is completed, we may not realize some or all of the anticipated benefits from the proposed Spin-off. Moreover, following the proposed Spin-off, the combined value of the common stock of the two publicly-traded companies may not be equal to or greater than what the value of our common stock would have been had the proposed Spin-off not occurred. In addition, we expect to spend substantial time, money and effort on completing the proposed transaction without any assurance that it will be completed. Our investments in terms of financial and management resources may be significantly higher than expected, which could limit our ability to pursue other business opportunities and distract us from operating our businesses as currently conducted.

Other than as discussed above, 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 January 2, 2015.

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.

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SIGNATURES

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

Dated: August 11, 2015

GREATBATCH, INC.

By: /s/ Thomas J. Hook
Thomas J. Hook
President and Chief Executive Officer
(Principal Executive Officer)

By: /s/ Michael Dinkins
Michael Dinkins
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)

By: /s/ Thomas J. Mazza
Thomas J. Mazza
Vice President and Corporate Controller
(Principal Accounting Officer)

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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

* Filed herewith.
** Furnished herewith.