GREATBATCH, INC.
Form 10-Q
November 10, 2009

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarter ended October 2, 2009

Commission File Number 1-16137

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

Delaware
(State of incorporation)

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

10000 Wehrle Drive
Clarence, New York
14031
(Address of principal executive offices)

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

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

Indicate by checkmark 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 ¨ No ¨

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

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

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

The number of shares outstanding of the Company's common stock, $0.001 par value per share, as of November 10, 2009 was: 23,190,401 shares.

GREATBATCH, INC.
TABLE OF CONTENTS FOR FORM 10-Q
AS OF AND FOR THE THREE AND NINE MONTHS ENDED OCTOBER 2, 2009

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

GREATBATCH, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS - Unaudited
(in thousands except share and per share data)

	As of October 2, 2009	As of January 2, 2009 (1)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 29,545	$ 22,063
Accounts receivable, net of allowance for doubtful accounts of $2.4 million in 2009 and $1.6 million in 2008	76,637	86,364
Inventories, net of reserve	115,761	112,304
Deferred income taxes	15,033	8,086
Prepaid expenses and other current assets	10,843	6,754
Total current assets	247,819	235,571
Property, plant and equipment, net	157,000	166,668
Amortizing intangible assets, net	84,474	90,259
Trademarks and tradenames	36,208	36,130
Goodwill	303,994	302,221
Deferred income taxes	2,413	1,942
Other assets	15,453	15,242
Total assets	$ 847,361	$ 848,033
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current liabilities:		
Current portion of long-term debt	$ 30,450	$ -
Accounts payable	28,804	48,727
Income taxes payable	2,570	4,128
Accrued expenses and other current liabilities	74,857	40,497
Total current liabilities	136,681	93,352
Long-term debt	265,656	314,384
Deferred income taxes	58,251	57,905
Other long-term liabilities	6,831	7,601
Total liabilities	467,419	473,242
Stockholders' equity:		
Preferred stock, $0.001 par value, authorized 100,000,000 shares; no shares issued or outstanding in 2009 or 2008	-	-
Common stock, $0.001 par value, authorized 100,000,000 shares; 23,190,401 shares issued and outstanding in 2009 and 22,970,916 shares issued and 22,943,176 shares outstanding in 2008	23	23
Additional paid-in capital	290,488	283,322
Treasury stock, at cost, no shares in 2009 and 27,740 shares in 2008	-	(741)
Retained earnings	87,796	95,263
Accumulated other comprehensive gain (loss)	1,635	(3,076)
Total stockholders’ equity	379,942	374,791
Total liabilities and stockholders' equity	$ 847,361	$ 848,033

(1) Retroactively adjusted - See Note 2.

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

GREATBATCH, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
AND COMPREHENSIVE INCOME (LOSS) - Unaudited
(in thousands except per share data)

	Three months ended		Nine months ended	
	October 2, 2009	September 26, 2008 (1)	October 2, 2009	September 26, 2008 (1)
Sales	$ 121,470	$ 136,242	$ 396,013	$ 400,044
Cost of sales	82,333	94,489	271,240	290,997
Gross profit	39,137	41,753	124,773	109,047
Operating expenses:				
Selling, general and administrative expenses	15,790	15,681	52,362	52,685
Research, development and engineering costs, net	9,701	6,793	26,270	23,722
Acquired in-process research and development	-	-	-	2,240
Litigation charge (Note 12)	34,500	-	34,500	-
Other operating expense, net	3,079	3,565	8,306	7,474
Total operating expenses	63,070	26,039	121,438	86,121
Operating income (loss)	(23,933)	15,714	3,335	22,926
Interest expense	4,895	4,981	14,714	14,948
Interest income	(22)	(142)	(49)	(663)
Other income, net	(112)	(234)	(509)	(1,597)
Income (loss) before provision (benefit) for income taxes	(28,694)	11,109	(10,821)	10,238
Provision (benefit) for income taxes	(8,001)	4,593	(3,354)	3,454
Net income (loss)	$ (20,693)	$ 6,516	$ (7,467)	$ 6,784
Earnings (loss) per share:				
Basic	$ (0.90)	$ 0.29	$ (0.33)	$ 0.30
Diluted	$ (0.90)	$ 0.28	$ (0.33)	$ 0.30
Weighted average shares outstanding:				
Basic	22,963	22,557	22,912	22,493
Diluted	22,963	24,087	22,912	22,697
Comprehensive income (loss):				
Net income (loss)	$ (20,693)	$ 6,516	$ (7,467)	$ 6,784
Foreign currency translation gain (loss)	4,871	(4,914)	4,888	366
Unrealized loss on cash flow hedges, net of tax	(213)	(351)	(177)	(26)
Unrealized loss on short-term investments available for sale, net of tax	-	(20)	-	-
Comprehensive income (loss)	$ (16,035)	$ 1,231	$ (2,756)	$ 7,124

(1) Retroactively adjusted - See Note 2.

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

GREATBATCH, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - Unaudited
(in thousands)

	Nine months ended	
	October 2, 2009	September 26, 2008 (1)
Cash flows from operating activities:		
Net income (loss)	$ (7,467)	$ 6,784
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	35,274	40,246
Stock-based compensation	6,833	8,073
Accrual for litigation charge	34,500	-
Acquired in-process research and development	-	2,240
Other non-cash (gains) losses	(615)	75
Deferred income taxes	(7,014)	1,073
Changes in operating assets and liabilities:		
Accounts receivable	11,035	(17,205)
Inventories	(2,230)	(8,055)
Prepaid expenses and other current assets	207	46
Accounts payable	(18,903)	15,555
Accrued expenses and other current liabilities	206	(631)
Income taxes payable	(1,583)	(1,163)
Net cash provided by operating activities	50,243	47,038
Cash flows from investing activities:		
Purchase of short-term investments	-	(2,010)
Proceeds from maturity/disposition of short-term investments	-	9,027
Acquisition of property, plant and equipment	(15,345)	(35,830)
Purchase of cost method investments	(1,050)	(2,550)
Acquisitions, net of cash acquired	-	(104,817)
Other investing activities	(571)	266
Net cash used in investing activities	(16,966)	(135,914)
Cash flows from financing activities:		
Principal payments of long-term debt	(37,000)	(40,651)
Proceeds from issuance of long-term debt	12,000	117,000
Other financing activities	(568)	334
Net cash provided by (used in) financing activities	(25,568)	76,683
Effect of foreign currency exchange rates on cash and cash equivalents	(227)	(1,265)
Net increase (decrease) in cash and cash equivalents	7,482	(13,458)
Cash and cash equivalents, beginning of year	22,063	33,473
Cash and cash equivalents, end of period	$ 29,545	$ 20,015

(1) Retroactively adjusted - See Note 2.

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

GREATBATCH, INC.
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY - Unaudited
(in thousands)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Treasury Stock Shares	Treasury Stock Amount	Retained Earnings	Accumulated Other Comprehensive Gain (Loss)	Total Stockholders' Equity
Balance, January 2, 2009 (1)	22,971	$ 23	$ 283,322	(28)	$ (741)	$ 95,263	$ (3,076)	$ 374,791
Stock-based compensation	-	-	3,725	-	-	-	-	3,725
Net shares issued under stock incentive plans	24	-	148	-	-	-	-	148
Income tax benefit from stock options and restricted stock	-	-	19	-	-	-	-	19
Shares contributed to 401(k) Plan	195	-	3,274	28	741	-	-	4,015
Net loss	-	-	-	-	-	(7,467)	-	(7,467)
Total other comprehensive income	-	-	-	-	-	-	4,711	4,711
Balance, October 2, 2009	23,190	$ 23	$ 290,488	-	$ -	$ 87,796	$ 1,635	$ 379,942

(1) Retroactively adjusted - See Note 2.

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

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

1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information (Accounting Standards Codification ("ASC") 270, Interim Reporting) and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information necessary for a fair presentation of financial position, results of operations, and cash flows in conformity with accounting principles generally accepted in the United States of America. Operating results for interim periods are not necessarily indicative of results that may be expected for the fiscal year as a whole. In the opinion of management, the condensed consolidated financial statements reflect all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of the results of Greatbatch, Inc. and its wholly-owned subsidiary Greatbatch Ltd. (collectively "Greatbatch" or the "Company") for the periods presented. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, sales, expenses, and related disclosures at the date of the financial statements and during the reporting period. Actual results could differ from these estimates. The January 2, 2009 condensed consolidated balance sheet data, as retroactively adjusted (See Note 2), was derived from audited consolidated financial statements but does not include all disclosures required by accounting principles generally accepted in the United States of America. For further information, refer to the consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended January 2, 2009. The Company utilizes a fifty-two, fifty-three week fiscal year ending on the Friday nearest December 31st. For 52-week years, each quarter contains 13 weeks. The third quarter of 2009 and 2008 each contained 13 weeks and ended on October 2, and September 26, respectively. The Company has evaluated subsequent events through November 10, 2009, the date of issuance of our condensed consolidated financial statements. The Company has revised its Condensed Consolidated Statements of Operations to include a presentation of Gross Profit and to combine intangible amortization expense related to cost of sales with Cost of Sales, which was previously broken out separately.

2. APPLICATION OF NEW ACCOUNTING POLICY

Beginning in 2009, the Company was required to adopt the provisions of ASC 470-20 related to the accounting for convertible debt instruments that may be settled in cash upon conversion. This change in accounting required issuers of convertible debt instruments that may be settled in cash upon conversion, such as the Company's CSN II as described in Note 6, to separately account for the liability and equity components of those instruments in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods.

Upon adoption, the Company determined the carrying amount of the liability component of CSN II by measuring the fair value of a similar liability that does not have the associated conversion option as of the date CSN II was issued (March 2007). The carrying amount of the conversion option was then determined by deducting the fair value of the liability component from the initial proceeds received from the issuance of CSN II. The carrying amount of the conversion option was retroactively recorded as Additional Paid-In Capital with an offset to Long-Term Debt. The carrying amount of the conversion option is being amortized to Interest Expense using the effective interest rate method over the expected life of a similar liability without a conversion option.

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

Deferred financing fees incurred in connection with the issuance of CSN II, previously recorded as Other Assets, were allocated to the liability and equity components in proportion to the allocation of proceeds between the liability and equity components. The deferred financing fees allocated to the debt component are being amortized to Interest Expense over the expected life of CSN II. The deferred financing fees allocated to the equity component were recorded as an offset to Stockholders' Equity.

As required, the 2008 Condensed Consolidated Financial Statements presented in this quarterly report have been retroactively adjusted to reflect the adoption of this change in accounting for convertible debt as if it were in effect on the date CSN II were originally issued. The following table provides the impact of this accounting change on the 2008 Condensed Consolidated Financial Statements:

(in thousands except per share amounts)	As Previously Reported	Impact of Accounting Change	Adjusted Amounts
Condensed Consolidated Balance Sheet			
(As of January 2, 2009)			
ASSETS			
Other assets	$ 16,140	$ (898)	$ 15,242
Total assets	848,931	(898)	848,033
LIABILITIES			
Long-term debt	$ 352,920	$ (38,536)	$ 314,384
Deferred income taxes - noncurrent	44,306	13,599	57,905
Total liabilities	498,179	(24,937)	473,242
STOCKHOLDERS' EQUITY			
Additional paid-in capital	$ 251,772	$ 31,550	$ 283,322
Retained earnings	102,774	(7,511)	95,263
Total stockholders' equity	350,752	24,039	374,791
Total liabilities and stockholders' equity	848,931	(898)	848,033
Condensed Consolidated Statement of Operations			
(Three months ended September 26, 2008)			
Interest expense	$ 3,268	$ 1,713	$ 4,981
Income before provision for income taxes	12,822	(1,713)	11,109
Provision for income taxes	5,193	(600)	4,593
Net income	7,629	(1,113)	6,516
Earnings per share:			
Basic	$ 0.34	$ (0.05)	$ 0.29
Diluted	0.33	(0.05)	0.28
(Nine months ended September 26, 2008)			
Interest expense	$ 9,908	$ 5,040	$ 14,948
Income before provision for income taxes	15,278	(5,040)	10,238
Provision for income taxes	5,218	(1,764)	3,454
Net income	10,060	(3,276)	6,784

Earnings per share:						
Basic	$	0.45	$	(0.15)	$	0.30
Diluted		0.44		(0.14)		0.30

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

(in thousands except per share amounts)	As Previously Reported	Impact of Accounting Change	Adjusted Amounts
Condensed Consolidated Statement of Cash Flows			
(Nine months ended September 26, 2008)			
Net income	$ 10,060	$ (3,276)	$ 6,784
Depreciation and amortization	35,206	5,040	40,246
Deferred income taxes	2,837	(1,764)	1,073
Net cash provided by operating activities	47,038	-	47,038

3. SUPPLEMENTAL CASH FLOW INFORMATION

	Nine months ended October 2, 2009	Nine months ended September 26, 2008
Noncash investing and financing activities (in thousands):		
Unrealized loss on cash flow hedges, net	$ 177	$ 26
Common stock contributed to 401(k) Plan	4,015	3,472
Property, plant and equipment purchases included in accounts payable	1,600	4,170
Deferred financing fees and acquisition costs included in accrued expenses and other current liabilities	-	293
Shares issued in connection with a business acquisition	-	1,473
Cash paid during the period for:		
Interest	$ 5,199	$ 6,020
Income taxes	4,502	2,643
Acquisition of noncash assets and liabilities:		
Assets acquired	$ 850	$ 167,195
Liabilities assumed	-	58,906

4. INVENTORIES, NET

Inventories are comprised of the following (in thousands):

	October 2, 2009	January 2, 2009
Raw materials	$ 56,480	$ 58,352
Work-in-process	29,920	28,851
Finished goods	29,361	25,101
Total	$ 115,761	$ 112,304

The above inventory amounts are shown net of a reserve for obsolescence of $13.2 million and $10.6 million as of October 2, 2009 and January 2, 2009, respectively.

- 9 -

5. INTANGIBLE ASSETS

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

	Gross carrying amount	Accumulated amortization	Foreign currency translation	Net carrying amount
October 2, 2009				
Purchased technology and patents	$ 82,673	$ (40,679)	$ 272	$ 42,266
Customer lists	46,818	(6,578)	729	40,969
Other	3,519	(2,297)	17	1,239
Total amortizing intangible assets	$ 133,010	$ (49,554)	$ 1,018	$ 84,474
January 2, 2009				
Purchased technology and patents	$ 81,639	$ (35,881)	$ 184	$ 45,942
Customer lists	46,547	(4,056)	271	42,762
Other	3,508	(1,964)	11	1,555
Total amortizing intangible assets	$ 131,694	$ (41,901)	$ 466	$ 90,259

Aggregate amortization expense for the third quarter of 2009 and 2008 was $2.4 million and $2.6 million, respectively. Aggregate amortization expense for the nine months ended October 2, 2009 and September 26, 2008 was $7.7 million and $8.1 million, respectively. As of October 2, 2009, annual amortization expense is estimated to be $2.6 million for the remainder of 2009, $9.6 million for 2010, $9.5 million for 2011, $9.4 million for 2012, $8.6 million for 2013 and $7.9 million for 2014.

The change in trademarks and trade names during 2009 is as follows (in thousands):

Balance at January 2, 2009	$ 36,130
Foreign currency translation	78
Balance at October 2, 2009	$ 36,208

The change in goodwill during 2009 is as follows (in thousands):

	Greatbatch Medical	Electrochem	Total
Balance at January 2, 2009	$ 292,278	$ 9,943	$ 302,221
Foreign currency translation	1,773	-	1,773
Balance at October 2, 2009	$ 294,051	$ 9,943	$ 303,994

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

6. DEBT

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

	October 2, 2009	January 2, 2009
Revolving line of credit	$ 107,000	$ 132,000
2.25% convertible subordinated notes I, due 2013	30,450	30,450
2.25% convertible subordinated notes II, due 2013	197,782	197,782
Unamortized discount	(39,126)	(45,848)
Total debt	296,106	314,384
Less: current portion of long-term debt	(30,450)	-
Total long-term debt	$ 265,656	$ 314,384

Revolving Line of Credit - The Company has a senior credit facility (the “Credit Facility”) consisting of a $235 million revolving credit facility, which can be increased to $335 million upon the Company’s request and approval by a majority of the lenders. The Credit Facility also contains a $15 million letter of credit subfacility and a $15 million swingline subfacility. In connection with the Electrochem Litigation described in Note 12 and pending the outcome of its post-trial motion, the Company will be required to bond the amount of the judgment and statutory interest in order to appeal. The Company intends to satisfy this requirement by posting a bond, which is expected to require partial collateralization. In anticipation of this, the Company has received approval from the lenders supporting the Credit Facility to increase the letter of credit subfacility by $35 million for use only in connection with bonding the appeal of the Electrochem Litigation.

The Credit Facility is secured by the Company’s non-realty assets including cash, accounts receivable and inventories, and has an expiration date of May 22, 2012 with a one-time option to extend to April 1, 2013 if no default has occurred. Interest rates under the Credit Facility are, at the Company’s option, based upon the current prime rate or the LIBOR rate plus a margin that varies with the Company’s leverage ratio as defined in the credit agreement. If interest is paid based upon the prime rate, the applicable margin is between minus 1.25% and 0.00%. If interest is paid based upon the LIBOR rate, the applicable margin is between 1.00% and 2.00%. The Company is required to pay a commitment fee between 0.125% and 0.250% per annum on the unused portion of the Credit Facility based on the Company’s leverage ratio as defined in the credit agreement. The calculation of the leverage ratio excludes certain “extraordinary, unusual or non-recurring” expenses or loss such as facility shutdown and consolidation costs (subject to certain limits as defined in the agreement), as well as up to $35 million in connection with the Electrochem Litigation.

The Credit Facility contains limitations on the incurrence of indebtedness, limitations on the incurrence of liens and licensing of intellectual property, limitations on investments and restrictions on certain payments. Except to the extent paid for by common equity of Greatbatch or paid for out of cash on hand, the Credit Facility limits the amount paid for acquisitions to $100 million. The restrictions on payments, among other things, limit repurchase of Greatbatch stock to $60 million and limits the ability of the Company to make cash payments upon conversion of CSN II. These limitations can be waived upon the Company’s request and approval of a simple majority of the lenders.

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

The Credit Facility also requires the Company to maintain a ratio of adjusted EBITDA, as defined in the credit agreement, to interest expense of at least 3.00 to 1.00, and a total leverage ratio, as defined in the credit agreement, of not greater than 5.00 to 1.00 from May 22, 2007 through September 29, 2009 and not greater than 4.50 to 1.00 from September 30, 2009 and thereafter. The calculation of adjusted EBITDA excludes certain “extraordinary, unusual or non-recurring” expenses or loss such as facility shutdown and consolidation costs (subject to certain limits as defined in the agreement), as well as up to $35 million in connection with the Electrochem Litigation. As of October 2, 2009, the Company was in compliance with all required covenants.

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

The weighted average interest rate on borrowings under the Company’s revolving line of credit as of October 2, 2009, which does not include the impact of the interest rate swaps described below, was 2.1%. Interest rates reset based upon the six-month ($98 million) and three-month ($9 million) LIBOR rate. As of October 2, 2009, the Company had $128 million available under its Credit Facility. This amount may vary from period to period based upon the debt levels of the Company as well as the level of EBITDA which impacts the covenant calculations described above.

Interest Rate Swaps – The Company has entered into three receive floating-pay fixed interest rate swaps indexed to the six-month LIBOR rate. The objective of these swaps is to hedge against potential changes in cash flows on the Company’s outstanding revolving line of credit, which is indexed to the six-month LIBOR rate. No credit risk was hedged. The receive variable leg of the swap and the variable rate paid on the revolving line of credit bear the same rate of interest, excluding the credit spread, and reset and pay interest on the same dates. The Company intends to continue electing the six-month LIBOR as the benchmark interest rate on the debt being hedged. If the Company repays the debt, it intends to replace the hedged item with similarly indexed forecasted cash flows. Information regarding the Company’s outstanding interest rate swaps is as follows:

Instrument	Type of hedge	Notional amount (In thousands)	Start date	End date	Pay fixed rate	Current receive floating rate	Fair value October 2, 2009 (In thousands)	Balance Sheet Location
Interest rate swap	Cash flow	$ 80,000	3/5/2008	7/7/2010	3.09%	1.75%	$ (1,358)	Oth Liabilities
Interest rate swap	Cash flow	18,000	12/18/2008	12/18/2010	2.00%	1.16%	(217)	Oth Liabilities
Interest rate swap	Cash flow	50,000	7/7/2010	7/7/2011	2.16%	6M LIBOR	(255)	Oth Liabilities
		$ 148,000			2.64%		$ (1,830)	

The estimated fair value of the interest rate swap agreements represents the amount the Company expects to receive (pay) to terminate the contracts and is recorded as Other Long-Term Liabilities in the Condensed Consolidated Balance Sheets. No portion of the change in fair value of the interest rate swaps during the first nine months of 2009 was considered ineffective. The amount recorded as additional interest expense during the first nine months of 2009 related to the interest rate swaps was $0.9 million.

Convertible Subordinated Notes - In May 2003, the Company completed a private placement of $170 million of 2.25% convertible subordinated notes, due June 15, 2013 ("CSN I"). In March 2007, the Company entered into separate, privately negotiated agreements to exchange $117.8 million of CSN I for an equivalent principal amount of a new series of 2.25% convertible subordinated notes due 2013 ("CSN II") (collectively the "Exchange") at a 5% discount. The primary purpose of the Exchange was to eliminate the June 15, 2010 call and put option that is included in the terms of CSN I. In connection with the Exchange, the Company issued an additional $80 million aggregate principal amount of CSN II at a price of $950 per $1,000 of principal. In December 2008, the Company entered into privately negotiated agreements under which it repurchased $21.8 million in aggregate principal amount of its outstanding CSN I at $845.38 per $1,000 of principal. The primary purpose of this transaction was to retire the notes, which contained a put option exercisable on June 15, 2010, at a discount.

The following is a summary of the significant terms of CSN I and CSN II:

CSN I - The notes bear interest at 2.25% per annum, payable semi-annually, and are due on June 15, 2013. Holders may convert the notes into shares of the Company's common stock at a conversion price of $40.29 per share, which is equivalent to a conversion ratio of 24.8219 shares per $1,000 of principal, subject to adjustment, before the close of business on June 15, 2013 only under the following circumstances: (1) during any fiscal quarter commencing after July 4, 2003, if the closing sale price of the Company's common stock exceeds 120% of the $40.29 conversion price for at least 20 trading days in the 30 consecutive trading day period ending on the last trading day of the preceding fiscal quarter; (2) subject to certain exceptions, during the five business days after any five consecutive trading day period in which the trading price per $1,000 of principal for each day of such period was less than 98% of the product of the closing sale price of the Company's common stock and the number of shares issuable upon conversion of $1,000 of principal; (3) if the notes have been called for redemption; or (4) upon the occurrence of certain corporate events. The fair value of CSN I as of October 2, 2009 was approximately $30 million and is based on recent sales prices.

Beginning June 20, 2010, the Company may redeem any of the notes at a redemption price of 100% of their principal amount, plus accrued interest. Note holders may require the Company to repurchase their notes on June 15, 2010 or at any time prior to their maturity following a fundamental change, as defined in the indenture agreement, at a repurchase price of 100% of their principal amount, plus accrued interest. As a result of this provision, beginning in the second quarter of 2009 the remaining balance of CSN I, along with the associated deferred tax liability and deferred fees, were classified as short-term in the Condensed Consolidated Balance Sheet and will be repaid with availability under the Company's revolving line of credit or cash flow from operations. The notes are subordinated in right of payment to all of our senior indebtedness and effectively subordinated to all debts and other liabilities of the Company's subsidiaries.

Beginning with the six-month interest period commencing June 15, 2010, the Company will pay additional contingent interest during any six-month interest period if the trading price of the notes for each of the five trading days immediately preceding the first day of the interest period equals or exceeds 120% of the principal amount of the notes.

CSN II - The notes bear interest at 2.25% per annum, payable semi-annually, and are due on June 15, 2013. The holders may convert the notes into shares of the Company's common stock at a conversion price of $34.70 per share, which is equivalent to a conversion ratio of 28.8219 shares per $1,000 of principal. The conversion price and the conversion ratio will adjust automatically upon certain changes to the Company's capitalization. CSN II notes were issued at a price of $950 per $1,000 of principal. The fair value of CSN II as of October 2, 2009 was approximately $177 million and is based on recent sales prices.

The effective interest rate of CSN II, which takes into consideration the amortization of the original discount, deferred fees related to the issuance of these notes and the discount recognized under ASC 470-20-30 (See Note 2) is 8.5%. The discount on CSN II is being amortized to the maturity date of the convertible notes utilizing the effective interest method. As of October 2, 2009, the carrying amount of the discount related to the ASC 470-20-30 equity component was $33.0 million. As of October 2, 2009, the if-converted value of CSN II notes does not exceed its principal amount as the Company's closing stock price of $21.63 did not exceed the conversion price of $34.70 per share.

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

	Three months ended		Nine months ended	
	October 2, 2009	September 26, 2008	October 2, 2009	September 26, 2008
Contractual interest	$ 1,113	$ 1,113	$ 3,338	$ 3,338
Discount amortization	2,278	2,132	6,722	6,293

The notes are convertible at the option of the holders at such time as: (i) the closing price of the Company's common stock exceeds 150% of the conversion price of the notes for 20 out of 30 consecutive trading days; (ii) the trading price per $1,000 of principal is less than 98% of the product of the closing sale price of common stock for each day during any five consecutive trading day period and the conversion rate per $1,000 of principal; (iii) the notes have been called for redemption; (iv) the Company distributes to all holders of common stock rights or warrants entitling them to purchase additional shares of common stock at less than the average closing price of common stock for the ten trading days immediately preceding the announcement of the distribution; (v) the Company distributes to all holders of common stock any form of dividend which has a per share value exceeding 5% of the price of the common stock on the day prior to such date of distribution; (vi) the Company affects a consolidation, merger, share exchange or sale of assets pursuant to which its common stock is converted to cash or other property; (vii) the period beginning 60 days prior to but excluding June 15, 2013; and (viii) certain fundamental changes, as defined in the indenture agreement, occur or are approved by the Board of Directors.

Conversions in connection with corporate transactions that constitute a fundamental change require the Company to pay a premium make-whole amount, based upon a predetermined table as set forth in the indenture agreement, whereby the conversion ratio on the notes may be increased by up to 8.2 shares per $1,000 of principal. The premium make-whole amount will be paid in shares of common stock upon any such conversion, subject to the net share settlement feature of the notes described below.

CSN II contains a net share settlement feature that requires the Company to pay cash for each $1,000 of principal to be converted. Any amounts in excess of $1,000 will be settled in shares of the Company's common stock, or at the Company's option, cash. The Company has a one-time irrevocable election to pay the holders in shares of its common stock, which it currently does not plan to exercise.

The notes are redeemable by the Company at any time on or after June 20, 2012, or at the option of a holder upon the occurrence of certain fundamental changes, as defined in the agreement, affecting the Company. The notes are subordinated in right of payment to all of our senior indebtedness and effectively subordinated to all debts and other liabilities of the Company's subsidiaries.

Deferred Financing Fees - The following is a reconciliation of deferred financing fees for the first nine months of 2009 (in thousands):

Previously reported balance at January 2, 2009	$ 4,994
ASC 470-20-30 adjustment	(898)
Retroactively adjusted amounts	4,096
Amortization during the period	(800)
Balance at October 2, 2009	$ 3,296

7. PENSION PLANS

The Company offers certain non-U.S. employees retirement benefits under defined benefit pension plans. Under these plans, benefits accrue to employees based upon years of service, position, age and compensation. The liability and corresponding expense related to these pension plans is based on actuarial computations of current and future benefits for employees. Pension expense is charged to current operating expenses.

The change in the net pension liability for the first nine months of 2009 is as follows (in thousands):

Balance at January 2, 2009	$ 5,985
Net periodic pension cost	816
Benefit payments	(607)
Employer contribution	(1,391)
Foreign currency translation	199
Balance at October 2, 2009	$ 5,002

The fair value of pension plan assets as of October 2, 2009 and January 2, 2009 was $9.9 million and $7.5 million, respectively. In order to reduce the underfunded status of one of its defined benefit pension plans, the Company made a $1.4 million cash contribution to that plan in July 2009.

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

	Three months ended		Nine months ended	
	October 2, 2009	September 26, 2008	October 2, 2009	September 26, 2008
Service cost	$ 228	$ 160	$ 656	$ 532
Interest cost	104	113	299	377
Amortization of net loss	33	-	95	-
Expected return on plan assets	(81)	(108)	(234)	(328)
Net pension cost	$ 284	$ 165	$ 816	$ 581

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

8. FAIR VALUE MEASUREMENTS

The following table provides information regarding assets and liabilities recorded at fair value in the Company's Condensed Consolidated Balance Sheet as of October 2, 2009 (in thousands):

		Fair value measurements using		
Description	At October 2, 2009	Quoted prices in active markets for identical assets	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets				
Foreign currency contracts	$ 165	$ -	$ 165	$ -