SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K
ANNUAL REPORT PURSUANT TO SECTION 13 OF
THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 1999 — Commission File No. 0-26224

INTEGRA LIFESCIENCES HOLDINGS CORPORATION
(Exact name of registrant as specified in its charter)

| Delaware | 51-0317849 |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. employer identification no.) |

| 105 Morgan Lane<br>Plainsboro, New Jersey | 08536 |
|---|---|
| (Address of principal executive offices) | (Zip Code) |

Registrant's telephone number, including area code: (609) 275-0500

Securities registered pursuant to Section 12(b) of the Act: None
Securities registered pursuant to Section 12(g) of the Act:

Common Stock, par value $.01 per share
(Title of class)

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 check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

The aggregate market value of the registrant's Common Stock held by non-affiliates of the registrant as of March 24, 2000 was approximately $134 million. (Reference is made to page 28 herein for a statement of the assumptions upon which this calculation is based.)

The number of shares of the registrant's Common Stock outstanding as of March 24, 2000 was 16,312,345.

DOCUMENTS INCORPORATED BY REFERENCE

Certain portions of the registrant's definitive proxy statement relating to its scheduled May 16, 2000 Annual Meeting of Stockholders are incorporated by reference in Part III of this report.

# PART I

## ITEM 1. BUSINESS

The terms "we", "our", "us" and "Integra" refer to Integra LifeSciences Holdings Corporation and its subsidiaries unless the context suggests otherwise.

Integra develops, manufactures and markets medical devices, implants and biomaterials. Our operations consist of (1) Integra NeuroSciences, which is a leading provider of implants, instruments, and monitors used in neurosurgery, neurotrauma, and related critical care and (2) Integra LifeSciences, which develops and manufactures a variety of medical products and devices, including products based on our proprietary tissue regeneration technology which are used to treat soft tissue and orthopedic conditions. Integra NeuroSciences sells primarily through a direct sales organization, and Integra LifeSciences sells primarily through strategic alliances and distributors.

Integra was founded in 1989 and over the next decade built a product portfolio based on resorbable collagen and a product and development platform based on technologies directed toward tissue regeneration. During 1999, we expanded into the neurosurgical market, an attractive niche market, through acquisitions and new products. Our 1999 revenues increased to $42.5 million as compared to $17.5 million in 1998.

In 1999, we sold over 1,000 different products to over 1,900 hospitals and other customers in more than 60 countries. We generate revenues from product sales, strategic alliances and royalties and invested $8.7 million in research and development relating to new products using our biomaterials, peptide chemistry and collagen engineering technologies.

Integra Neurosciences accounted for 54% of total revenues in 1999. We market these products to neurosurgeons and critical care units, which comprise a focused group of hospital-based practitioners. As a result, we are able to access this market through a cost-effective sales and marketing infrastructure.

For the majority of the products we manufacture under Integra LifeSciences, we partner with market leaders, which we believe allows us to achieve our growth objectives cost effectively while enabling us to focus our management efforts on developing new products. Our strategic alliances include Johnson & Johnson Medical, a division of Ethicon, Inc., Sulzer Medica Ltd., the Linvatec division

of CONMED Corporation, Bionx Implants, Inc., the Genetics Institute division of American Home Products Corporation, the Sofamor-Danek division of Medtronic, Inc. and Baxter Healthcare.

Strategy

Our goal is to become a leader in the development, manufacture and marketing of medical devices, implants and biomaterials in the markets in which we compete. Our products are principally used in the diagnosis and treatment of acute or chronic neurosurgical, soft-tissue and orthopedic conditions and we intend to expand our presence in those markets. Key elements of our strategy include the following:

Expand our neurosurgery market presence. Through acquisitions and internal growth, we have rapidly grown Integra NeuroSciences into a leading provider of devices for the neurosurgery market. We believe there exists additional growth potential in this market through:

- Increasing market share of existing product lines;
- Expanding our product portfolio through acquisitions; and
- Continuing development and promotion of innovative products, such as our recently introduced DuraGen(TM) Dural Graft Matrix.

Continue to develop new and innovative medical products. As evidenced by our development of INTEGRA(R) Artificial Skin, Biomend(R) and DuraGen(TM), we have a leading proprietary resorbable implant franchise. INTEGRA(R) Artificial Skin is a proprietary resorbable collagen used to enable the human body to regenerate functional dermal tissue. In 1999, we introduced our DuraGen(TM) dural graft matrix to close brain and spine casings. We are currently developing a variety of innovative neurosurgical and non-neurosurgical medical products using our resorbable collagen technology as well as expanded applications for our existing products.

Continue to form strategic alliances for Integra LifeSciences products. We have collaborated with leading companies to develop and market the majority of our non-neurosurgical product lines. These products address large and diverse markets, and we believe that they can be more cost effectively sold through marketing partners than through developing our own sales infrastructure. We recently partnered with Johnson & Johnson Medical to market our INTEGRA(R) Artificial Skin and intend to pursue additional strategic alliances selectively.

Additional strategic acquisitions. Since March 1999 we have completed or entered into contracts for three acquisitions in the neurosurgical market. We intend to seek additional acquisitions in this market and seek strategic acquisitions in other niche medical technology areas characterized by high margins, fragmented competition and focused target customers.

Products

We manufacture and market a broad range of medical products for the diagnosis and treatment of spinal and cranial disorders, soft tissue repair and orthopedic conditions. We are also actively engaged in a variety of research and development programs relating to new products or product enhancements utilizing our tissue regeneration technology. Our products and products under development are summarized in the following table.

Integra NeuroSciences

| Product | Application | Status |
|---|---|---|
| Camino(R) and Ventrix(R) fiber optic-based intracranial pressure monitoring systems and Clinical Neuro Systems(TM) drainage systems & cranial access kits | For continuous pressure and temperature monitoring of the brain following injury, and drainage of excess fluid | Marketed |
| Heyer - Schulte(R) neurosurgical shunts | Specifically designed for the maintenance of the chronic condition, hydrocephalus (i.e., excess pressure in the brain) | Marketed |

Integra NeuroSciences, continued

| Product | Application | Status |
| --- | --- | --- |
| DuraGen(TM) Dural Graft Matrix (absorbable collagen-based) | Graft to close brain and spine casing | Marketed |
| Redmond(TM) neurosurgical and spinal instruments | Specialized surgical instruments for use in brain or spinal surgery | Marketed |
| Neuro-Navigational(R) flexible endoscopes for neurosurgery | For minimally invasive surgical access to the brain | Marketed |
| Helitene(R) Microfibrillar Hemostat | Control of bleeding during surgery | Approved in Europe; Pending approval for neurosurgical use in U.S. |
| Peripheral nerve conduit | Repair of peripheral nerves | Development |

Integra LifeSciences

| Product | Application | Status | Marketing/Development Partner |
| --- | --- | --- | --- |
| INTEGRA(R) Artificial Skin | Regenerate dermis and skin defects | Marketed | Johnson & Johnson Medical, Century Medical, Inc. |
| BioMend(R) and Biomend(R) Extend, Absorbable Collagen Membrane | Used in guided tissue regeneration in periodontal surgery | Marketed | Sulzer Medica |
| Articular cartilage repair | Regeneration of joint cartilage | Development | DePuy division of Johnson & Johnson |
| Collagen material for use with bone morphogenetic protein (rhBMP-2) | Fracture management/enabling spinal fusion | Development | Genetics Institute (AHP), Medtronic Sofamor Danek |
| Tyrosine polycarbonates for fixation devices such as resorbable screws, plates, pins, wedges and nails | Fixation or alignment of fractures | Development | Linvatec (CONMED), Bionx Implants, Inc. |

| | | | |
|---|---|---|---|
| VitaCuff(TM) | Provides protection against infection arising from long-term catheters | Marketed | Bard Access Systems, Inc., Arrow International, Inc |
| BioPatch(TM) | Anti-microbial wound dressing | Marketed | Johnson & Johnson Medical |
| Helitene(R) and Helistat(R) absorbable collagen hemostatic agents | Control of bleeding | Marketed | Sold through various distributors |
| CollaCote(R), CollaTape(R) and CollaPlug(R) absorbable wound dressings | Used to control bleeding in dental surgery | Marketed | Sulzer Medica |
| Sundt(R) Shunt | Carotid endarterectomy shunts for shunting blood during surgical procedures involving blood vessels | Marketed | Sold directly and through various distributors |

INTEGRA NEUROSCIENCES

In General

We manufacture and market a multi-line offering of innovative neurosurgical devices used for brain and spine injuries. We intend to be the neurosurgeon's and intensive care unit's "one-stop shop" for these products. For the intensive care unit, we sell the Camino(R) and Ventrix(R) lines of intracranial pressure ("ICP") monitoring systems and external drainage systems manufactured under the Camino(R), Heyer-Schulte(R) and Clinical Neuro Systems(TM) brand names. For the operating room, we sell a wide range of products, including cerebrospinal fluid ("CSF") shunting products, the DuraGen(TM) Dural Graft Matrix, Neuro Navigational(R) endoscopes, and Redmond(TM) neurosurgical instruments.

We sell our neurosurgical products in the United States through a direct sales force organized into five regions each with a region manager. We employ 27 direct sales personnel called neurospecialists covering 40 territories. We intend to increase the number of sales personnel to 40. We also employ seven clinical development specialists who directly educate and train both the neurospecialists and our customers in the use of our products. In addition, we employ a physician as medical director, and a Ph.D. in neurosciences as scientific director. The sales organization has approximately doubled in size since the acquisition of the first neurosciences business in early 1999. We believe this expansion allows for smaller, more focused territories, greater participation in trade shows and more extensive marketing efforts.

Outside of the United States, we sell our products through approximately 60 specialized neurosurgical distributors and dealers.

Industry

Integra NeuroSciences addresses the market need created by trauma cases and hydrocephalus through its established market positions in ICP monitoring, neurosurgical shunting, neuroendoscopy and specialty neurosurgical instrumentation. Integra NeuroSciences currently has more than 3,000 ICP monitors installed worldwide.

ICP monitors are used by neurosurgeons in diagnosing and treating cases of severe head trauma and other diseases. There are approximately 400,000 cases of head trauma each year in the United States.

Hydrocephalus is an incurable condition resulting from an imbalance between the amount of CSF produced by the body and the rate at which CSF is absorbed by the brain. This condition causes the ventricles of the brain to enlarge and the pressure inside the head to increase. Hydrocephalus often is present at birth, but may also result from head trauma, spina bifida, intraventricular hemorrhage, intracranial tumors and cysts. The most common method of treatment of hydrocephalus is the insertion of a shunt into the ventricular system of the brain to divert the flow of CSF out of the brain. A pressure valve then maintains the CSF at normal levels within the ventricles. According to the Hydrocephalus Association, hydrocephalus affects approximately one in 500 children born in the United States. Approximately 80% of total CSF shunt sales address birth-related hydrocephalus with the remaining 20% addressing surgical procedures involving excess CSF due to head trauma.

Integra NeuroSciences's design, manufacture and production of minimally invasive neuroendoscopy products addresses what we believe is significant growth potential in the neuroendoscopy market resulting from an increasing number of neurosurgeons embracing minimally invasive surgical techniques. We believe that the worldwide market for neuroendoscopy products will grow more quickly than most other neurosurgical device lines. This growth is expected, in part, because of the introduction of new procedures called third ventriculostomies which are increasingly substituting for shunt placement for patients who meet the criteria. Accordingly, we believe that our Neuro Navigational(R) line of disposable, semi-flexible, fiber-optic scopes will continue to grow and that the Neuro Navigational(R) line addresses the needs of neurosurgeons employing these techniques.

Our DuraGen(TM) product line addresses the market for dural substitutes, including cranial and spinal procedures.

Integra NeuroSciences's broad line of neurosurgery and spinal instrumentation products, including hand-held spinal and neurosurgery instruments such as retractors, kerrisons, dissectors and curettes, addresses the market for neurosurgical instruments.

Products

Intracranial Pressure Product Line. Integra NeuroSciences sells the Camino(R) and Ventrix(R) lines of intracranial pressure monitoring systems. Core technologies in the intracranial pressure monitoring product line include the design and manufacture of the disposable catheters used in the monitoring systems, patented pressure transducer technology, optical detection/fiber optic transmission technology, sensor characterization and calibration technology and monitor design and manufacture. The research, development and manufacture of Integra NeuroSciences's ICP monitoring products are located in San Diego, California.

External Drainage System Product Line. Integra NeuroSciences's external drainage systems are manufactured under the Camino(R), Heyer-Shulte(R) and Clinical Neuro Systems(TM) brand names. We manufacture the drainage systems in both Anasco, Puerto Rico (for sale under the Camino(R) and Heyer-Schulte(R) brand names) and in Exton, Pennsylvania (for sale under the Clinical Neuro Systems(TM) brand name).

Shunts for Hydrocephalus Management. Our line of shunting products for hydrocephalus management includes the Novus, LPV and Pudenz shunts, ventricular, peritoneal and cardiac catheters, physician-specified hydrocephalus management shunt kits, Ommaya CSF reservoirs and Spetzler lumbar and syringo-peritoneal shunts. Shunts are implanted in the patient to drain excess CSF from the ventricles of the brain into the peritoneal cavity or externally. Integra NeuroSciences's hydrocephalus management shunt manufacturing operations are located in the Anasco, Puerto Rico facility.

DuraGen(TM) Product Line. The DuraGen(TM) Dural Graft Matrix is a resorbable collagen matrix indicated for the repair of the dura mater. The dura mater is the thick membrane that contains the CSF within the brain and the spine. The dura mater must be penetrated during brain surgery, and is often nicked or otherwise damaged during spinal surgery. In either case, surgeons often close or repair the dura mater with a graft. The graft may consist of other tissue taken from elsewhere in the patient's body, or it may be one of the dural substitute products currently on the market which are made of synthetic materials, processed human cadaver, or bovine pericardium. We believe that each of the prevailing methods for repairing the dura mater suffer from shortcomings addressed by the DuraGen(TM) Dural Graft Matrix. We manufacture the DuraGen(TM) Dural Graft Matrix product in our Plainsboro, New Jersey facility.

Our DuraGen(TM) product is an engineered resorbable collagen implant that has been shown in clinical trials to be an effective means for closing the dura mater without the need for suturing, which allows the neurosurgeon to conclude the operation more efficiently. In addition, because the DuraGen(TM) product is ultimately resorbed by the body and replaced with new natural tissue, the patient avoids some of the risks associated with a permanent implant inside the cranium.

Redmond(TM) Product Line. We provide neurosurgeons and spine surgeons with a full line of specialty hand-held spinal and neurosurgical instruments sold under the Redmond(TM) brand name. These products include retractors, kerrisons, dissectors and curettes. Major product segments include spinal instruments, microsurgical neuro instruments, and products customized by Integra NeuroSciences and sold through other companies and distributors. We import most of these instruments from Germany.

Neuro Navigational(R) Endoscope Product Line. We manufacture and sell disposable minimally invasive neuroendoscopy products under the Neuro Navigational(R) brand name. These fiber optic instruments are used to facilitate minimally invasive neurosurgery. Neuroendoscopy manufacturing operations are located in San Diego, California.

Helitene(R) Neurosurgical Hemostat Product Line. Helitene(R) hemostatic agent consists of microfibular collagen, and is intended to control bleeding during surgery. Outside of the United States, it is indicated for use in neurosurgery, in addition to general surgery. During 2000, Integra NeuroSciences will begin to sell Helitene(R) outside of the United States for use in neurosurgery.

Peripheral Nerve Conduit Product Line. Although peripheral nerves are one of the few tissues of the body that spontaneously regenerate, in the majority of cases they fail to make useful, functional connections. Consequently, peripheral nerve injuries often result in permanent loss of sensation and motor control. At present, there is no product on the market that regenerates peripheral nerves. The conventional method of treatment for a severed peripheral nerve is microsurgical repair or nerve grafts. Our peripheral

nerve regeneration device is a collagen tube designed to facilitate regeneration of the severed nerve and to act as a bridge between the severed nerve ends. The collagen conduit supports nerve regeneration and is then absorbed into the body. Our pre-clinical studies have demonstrated the closure of 5-cm gaps in peripheral nerves in non-human primates with restored nerve function. Our proprietary resorbable conduit for regenerating and reconnecting peripheral nerves is expected to enter clinical trials in Europe in humans during the first half of 2000.

INTEGRA LIFESCIENCES

In General

Integra LifeSciences develops and markets tissue regeneration products and sells surgical products that are primarily sold outside of neurosurgery and neurotrauma. Many of the current products of Integra LifeSciences are built on our expertise in resorbable collagen products. Integra LifeSciences's research and development programs are generally constructed around strategic alliances with leading medical device companies.

Products

INTEGRA(R) Artificial Skin. INTEGRA(R) Artificial Skin is designed to enable the human body to regenerate functional dermal tissue. Human skin consists of the epidermis and the dermis. The epidermis is the thin, outer layer that serves as a protective seal for the body and the dermis is the thicker layer underneath that provides structural strength and flexibility and supports the viability of the epidermis through a vascular network. The body normally responds to severe damage to the dermis by producing scar tissue in the wound area. This scar tissue is accompanied by contraction that pulls the edges of the wound closer which, while closing the wound, often permanently reduces flexibility. In severe cases, this contraction leads to a reduction in the range of motion for the patient, who subsequently requires extensive physical rehabilitation or reconstructive surgery. Physicians treating severe wounds, such as full-thickness burns, seek to minimize scarring and contraction.

INTEGRA(R) Artificial Skin was designed to minimize scar formation and wound contracture in full thickness skin defects. INTEGRA(R) Artificial Skin consists of two layers, a thin collagen-glycosaminoglycan sponge and a silicone membrane. The product is applied with the sponge layer in contact with the excised wound. The sponge material serves as a template for the growth of new functional dermal tissue. The outer membrane layer acts as a temporary substitute for the epidermis to control water vapor transmission, prevent re-injury and minimize bacterial contamination.

INTEGRA(R) Artificial Skin is marketed and sold, except in Japan, by Johnson & Johnson Medical. INTEGRA(R) Artificial Skin was approved by the FDA under a premarket approval application ("PMA") for the post-excisional treatment of life-threatening full-thickness or deep partial-thickness thermal injury where sufficient autograft is not available at the time of excision or not desirable due to the physiological condition of the patient. The FDA's approval order includes requirements to provide a comprehensive practitioner training program and to conduct a post approval study at multiple clinical sites. We have enrolled more than the required number of patients in the post-approval study, and expect to file the results with the FDA this year.

We estimate that the worldwide market for use of skin replacement products (such as INTEGRA(R) Artificial Skin) in the treatment of severe burns is only about $75 million. However, the potential market for the use of INTEGRA(R) Artificial Skin for reconstructive surgery and the treatment of chronic wounds is much larger, which we estimate to be in excess of $1 billion. In June 1999, Integra LifeSciences

entered into a strategic alliance with Johnson & Johnson Medical to distribute INTEGRA(R) Artificial Skin throughout the world, except Japan. As part of that strategic alliance, Johnson & Johnson Medical has agreed to pay for clinical trials to support applications to the FDA for these broader indications. We cannot be certain that such clinical trials will be completed, or that INTEGRA(R) Artificial Skin will receive the approvals necessary to permit Johnson & Johnson Medical to promote it for such indications.

BioMend(R) Absorbable Collagen Membrane. Integra LifeSciences has also developed the BioMend(R) Absorbable Collagen Membrane for use in guided tissue regeneration in periodontal surgery. The BioMend(R) membrane is inserted between the gum and the tooth after surgical treatment of periodontal disease, preventing the gum tissue from interfering with the regeneration of the periodontal ligament that holds the tooth in place. The BioMend(R) product is intended to be absorbed after approximately four to seven weeks, avoiding the requirement for additional surgical procedures to remove a non-absorbable membrane. The BioMend(R) Absorbable Collagen Membrane is sold through the Calcitek division of Sulzer Medica. It has been approved for marketing in the United States and has received CE Mark certification for sales in the European Union. Sulzer Medica is seeking regulatory approval in Japan. BioMend(R) Extend was developed by Integra LifeSciences and has the same indication for use as BioMend(R) except that it absorbs in approximately 16 weeks. The product has received FDA clearance to market, and has been submitted for CE mark certification and for approval in Canada and Japan.

Cartilage Repair Products. Damaged articular cartilage, which connects the skeletal joints, is associated with the onset of progressive pain, degeneration and, ultimately, long-term osteoarthritis. Normal articular cartilage does not effectively heal. The conventional procedure for treating traumatic damage to cartilage involves smoothing damaged portions of the tissue and removing free-floating material from the joint using arthroscopic surgery with the objective of reducing pain and restoring mobility. However, this therapy does not stop joint surface degeneration, often requires two or more surgeries and results in the formation of fibrocartilage, which is rough and non-weight bearing over prolonged periods. Moreover, the long-term result of this procedure often is permanent reduction of joint mobility and an increased risk of developing osteoarthritis.

We are developing a device to allow in vivo regeneration of the patient's own articular cartilage. This technology will allow the patient's body to regenerate a smooth, weight-bearing surface. Our objective in developing this cartilage-specific technology is to produce a product that provides the proper matrix system to allow the natural regeneration of the patient's cartilage, with full restoration of function and diminished risk of osteoarthritis.

The product under development would use our proprietary peptide technology to encourage cells to grow into the template once implanted into the patient. Our peptide portfolio includes bioactive agents designed to mimic natural proteins to promote cell adhesion, cell survival and other important cellular functions. Our product would employ proprietary designs based on multiple layers of collagen material of varying but tightly controlled densities and pore sizes to provide a scaffold for all proliferation and cartilage formation. Simultaneously it would prevent the in-growth of unwanted cells that could lead to scar tissue formation. We anticipate that the device will be absorbed into the body over a period of several weeks. Pre-clinical studies involving several variations of the above protocols are in progress.

Collagen matrices for use with rhBMP-2. We supply the Genetics Institute division of American Home Products with absorbable collagen sponges for use in developing bone regeneration implants. Since 1994, we have supplied absorbable collagen sponges for use with Genetics Institute's recombinant human bone morphogenic protein-2 (rhBMP-2). Recombinant human BMP-2 is a manufactured version of human protein naturally present in very small quantities in the body. Genetics Institute is developing rhBMP-2

for clinical evaluation in several areas of bone repair and augmentation. Spine applications are being developed through a related collaboration with Medtronic Sofamor Danek in North America.

Tyrosine polycarbonates for orthopedic implants. We are continuing to develop additional biomaterial technologies that enhance the rate and quality of healing and tissue regeneration with synthetic biodegradable scaffolds that support cell attachment and growth. We are developing a new class of resorbable polycarbonates created through the polymerization of tyrosine, a naturally occurring amino acid. A well-defined and commercially scaleable manufacturing process prepares these materials. Device fabrication by traditional techniques such as compression molding and extrusion is readily achieved. We believe that this new biomaterial will be useful in promoting full bone healing when implanted in damaged sites. This material is currently being developed for orthopedic and tissue engineering applications where strength and bone compatibility are critical issues for success of healing. We have entered into agreements to supply the material to Bionx Implants, Inc. and the Linvatec division of CONMED, in each case for specified orthopedic implants. No medical device containing the material has yet been approved for sale.

Other Surgical Products. Other current products of Integra LifeSciences include the VitaCuff(TM) catheter access infection control device (sold to Bard Access Systems, Inc., Arrow International, Inc. and the Quinton division of Tyco International Ltd.), the BioPatch(TM) anti-microbial wound dressing (sold to Johnson & Johnson Medical), and a wide range of resorbable collagen products for hemostasis (sold to Sulzer Calcitek for use in periodontal surgery, and to Baxter International and other distributors under the Helistat(R) and Helitene(R) Absorbable Collagen Hemostatic Agent names). All of the foregoing products are manufactured at our Plainsboro, New Jersey manufacturing facility.

Finally, our line of Sundt(R) carotid endarterectomy shunts is used to divert blood to vital organs (such as the brain) during carotid artery surgical procedures. Carotid shunts are manufactured at our medical-grade silicone manufacturing facility in Anasco, Puerto Rico, and sold directly and through distributors.

## SALES AND MARKETING

Our sales and marketing strategy for our product lines differ based on the type of market and our assessment of how we can maximize our resources and make the greatest impact on the respective market. We market our Integra NeuroSciences products to neurosurgeons and critical care units, which comprise a focused group of hospital-based practitioners. As a result, we are able to access this market through a cost-effective sales and marketing infrastructure. For the majority of the products we manufacture under Integra LifeSciences, we partner with market leaders, which we believe allows us to achieve our growth objectives cost effectively while enabling us to focus our management efforts on developing new products. The non-neurosurgical products represent large, diverse markets, and we believe that they can be more cost effectively promoted through leveraging leading marketing partners than through developing a sales infrastructure ourselves. Our strategic alliances include Johnson & Johnson Medical, a division of Ethicon, Inc., Sulzer Medica Ltd., the Linvatec division of CONMED Corporation, Bionx Implants, Inc., the Genetics Institute division of American Home Products Corporation, the Sofamor Danek division of Medtronic, Inc. and Baxter Healthcare.

STRATEGIC ALLIANCES

We use distribution alliances to market the majority of our Integra LifeSciences products. We have also entered into collaborative agreements relating to research and development programs involving our technology. These arrangements are described below.

In June 1999, Integra LifeSciences entered into a strategic alliance with Johnson & Johnson Medical to distribute INTEGRA(R) Artificial Skin throughout the world, except in Japan. Johnson & Johnson Medical is responsible for marketing and selling the product, has agreed to make significant minimum product purchases, and will provide $2 million annual funding for research, development and certain clinical trials for the first five years of the alliance and thereafter based on a percentage of net sales. In addition, Johnson & Johnson Medical is obligated to make contingent payments to Integra LifeSciences in the event of certain clinical developments and to assist in the expansion of our manufacturing capacity as we achieve certain sales targets. Under the agreement, we are obligated to manufacture the product and are responsible for continued research and development.

In 1997, we signed an exclusive importation and sales agreement for INTEGRA(R) Artificial Skin in Japan with Century Medical Inc., a subsidiary of ITOCHU Corporation. Under this agreement, Century Medical, Inc. is conducting a clinical trial in Japan at its own expense to obtain Japanese regulatory approvals for the sale of INTEGRA(R) Artificial Skin in Japan.

In February 1998, we announced the signing of a strategic alliance with Johnson & Johnson's DePuy division ("DePuy") to develop and market a new product to regenerate joint cartilage. Integra LifeSciences has agreed to develop an absorbable, collagen-based implant, designed in combination with its proprietary RGD peptide technology, that will allow the body to repair and regenerate articular cartilage found in the knee and other joints. DePuy will market the product worldwide. Under the terms of the agreement, DePuy will make payments of up to $13 million as Integra meets various milestones, and will fund all necessary development costs beyond the pre-clinical phase. If a product is successfully developed, we will be responsible for manufacturing the product and for future product development.

In addition to the cartilage program, Integra LifeSciences has several other programs oriented toward the orthopedic market. These programs include alliances for the development of resorbable orthopedic implants made of our proprietary tyrosine polycarbonate technology with Bionx Implants, Inc. and Linvatec and an alliance with Genetics Institute for the development of collagen matrices to be used in conjunction with Genetics Institute's recombinant human bone morphogenetic protein-2 ("rhBMP-2"). If approved, rhBMP-2 is expected to be used in conjunction with our matrices to regenerate bone. Genetics Institute is developing products based on rhBMP-2 for applications in orthopedics, oral and maxillofacial surgery and spine surgery. Spine applications are being developed through a related collaboration with Medtronic Sofamor Danek in North America.

In September 1998, we announced two strategic alliances with Linvatec and Bionx Implants, Inc. for developing fixation devices using Integra's polymer technology. Under the agreements with Linvatec and Bionx Implants, those companies have responsibility for clinical trials and any necessary regulatory filings, as well as certain minimum annual purchase payments. Products covered under the agreement with Linvatec include a resorbable line of interference screws, as well as tacks and anchors used in reconstruction of the anterior cruciate ligament and posterior cruciate ligament, fixation of ligaments and tendons in the knee and shoulder, and bone-tendon-bone procedures. Linvatec also intends to develop polymer implants for use in bladder neck suspension procedures. Products covered under the agreement with Bionx Implants

include a resorbable line of screws, plates, pins, wedges and nails used for the fixation and/or alignment of fractures or osteotomies in all areas of the musculoskeletal system except in the spine and cranium.

Sulzer Medica's dental division, Sulzer Calcitek, has marketed and sold BioMend(R) since 1995, BioMend Extend(TM) since 1999 and CollaCote(R), CollaPlug(R) and CollaTape(R) since 1992.

## RESEARCH STRATEGY

The Company has either acquired or secured the proprietary rights to several important scientific platforms. These technologies provide support for the Company's critical applications in neurosciences and tissue regeneration, and additional opportunities for generating near-term and long-term revenues from medical applications. The Company has been able to identify and bring together critical platform technology components from which it works to develop solutions for both tissue regeneration and neurosciences.

The Company spent approximately $8.7 million, $8.2 million and $6.2 million during 1999, 1998 and 1997, respectively, on research and development activities. Research and development activities funded by government grants and contract development revenues amounted to $1.9 million, $1.8 million and $490,000 during 1999, 1998 and 1997, respectively.

## GOVERNMENT REGULATION

Our research and development activities and the manufacturing and marketing of our existing and future products are subject to regulation by numerous governmental agencies in the United States and in other countries. The FDA and comparable agencies in other countries impose mandatory procedures and standards for the conduct of clinical trials and the production and marketing of products for diagnostic and human therapeutic use. The FDA product approval process has different regulations for drugs, biologics, and medical devices. The FDA currently classifies our proposed regenerative medicine products as medical devices.

### Review Process For Medical Devices

There are two types of FDA review/approval procedures for medical devices: a Premarket Notification Section 510(k) ("510(k)") and a PMA application. A 510(k) requires submission of sufficient data to demonstrate substantial equivalence to a device marketed prior to May 28, 1976, or to a device marketed after that date which has been classified into Class I or Class II which has received premarket notification 510(k) clearance. Although the mandated period for FDA review is 90 days, actual review times can be substantially longer, and the sponsor cannot market the device until FDA clearance is obtained. For those devices that involve new technology and/or that present significant safety and effectiveness issues, 510(k) submissions may require significantly more time for FDA review and may require submission of more extensive safety and effectiveness data, including clinical trial data.

Among the conditions for clearance to market of a 510(k) submission is the requirement that the prospective manufacturer's quality control and manufacturing procedures conform to the FDA's current Quality System Regulations. In complying with standards set forth in these regulations, manufacturers must expend time, money and effort for production and quality control to ensure full technical compliance at all times. Manufacturing establishments, both international and domestic, are also subject to inspections by or under the authority of the FDA. Although, at present, the FDA generally does not inspect such establishments prior to clearance of a 510(k) submission, it is establishing a program of conducting Quality System inspections for new devices in the future as a standard practice.

The Medical Device Amendments of 1976 amended the Federal Food, Drug and Cosmetics Act to establish three regulatory classes for medical devices, based on the level of control required to assure safety and effectiveness. Class III Devices are defined as life-supporting and life-sustaining devices, devices of substantial importance in preventing impairment of human health or devices that present potentially unreasonable risk of illness or injury. Class III devices are those for which there is insufficient information to show that Class I or Class II controls can provide a reasonable assurance of safety or effectiveness. The PMA application review process for Class III devices was established to evaluate the safety and effectiveness of these devices on a product by product basis. Manufacturers that wish to market Class III devices must submit and receive approval of a PMA application from the FDA.

The FDA has substantial content and format requirements for PMA applications, which include clinical and non-clinical safety and effectiveness data, labeling, manufacturing processes and quality assurance programs. As part of the PMA application process, the PMA application may be referred to an FDA Advisory Panel for review. Additionally, final approval of the product is dependent on an inspection of the manufacturing facility for compliance with FDA Quality System Regulations.

All studies in the United States in humans for the purpose of investigating the safety and effectiveness of an investigational significant risk medical device must be conducted under the Investigational Device Exemption ("IDE") regulations. An IDE application to the FDA includes all preclinical biocompatibility testing, investigational protocols, patient informed consents, reports of all prior investigations, manufacturing and quality control information. It takes a number of years from initiation of the project until submission of a PMA application to the FDA, and requires the expenditure of substantial resources. If a PMA application is submitted, however, there can be no assurance on the length of time for the review process at the FDA or that the FDA will approve the PMA application.

Under either the 510(k) submission or PMA application process, manufacturing establishments, foreign and domestic, are subject to periodic inspections by the FDA for compliance with Quality System Regulations. The Company and each of its operating subsidiaries are subject to such inspections. To gain approval for the use of a product for clinical indications other than those for which the product was initially evaluated or for significant changes to the product, further studies, including clinical trials and FDA approvals, are required. In addition, for products with an approved PMA application, the FDA requires postapproval reporting and may require postapproval surveillance programs to monitor the product's safety and effectiveness. Results of post-approval programs may limit or expand the further marketing of the product.

International Regulatory Requirements

We are preparing for the changing international regulatory environment. "ISO 9000" is an international recognized set of guidelines that are aimed at ensuring the manufacture and development of quality products. We were audited under ISO standards in 1997 and received certification to ISO 9001, a full quality system. In 1998, we underwent a surveillance audit and renewed our certification to ISO 9001. We are required to be audited on an annual basis by a recognized notified body to maintain certification. Companies that meet ISO standards are internationally recognized as functioning under a quality system. Approval of a product by regulatory authorities in international countries must be obtained prior to the commencement of marketing of the product in such countries. The requirements governing the conduct of clinical trials and product approvals vary widely from country to country, and the time required for approval may be longer or shorter than that required for FDA approval of the PMA application. In June 1998, the European Union Medical Device Directive became effective, and all medical devices must meet the Medical Device Directive standards and receive CE mark certification. CE mark certification involves a comprehensive quality system program, and submission of data on a product to the notified body in Europe.

## Other United States Regulatory Requirements

In addition to the regulatory framework for product approvals, we are and may be subject to regulation under federal and state laws, including requirements regarding occupational health and safety; laboratory practices; and the use, handling and disposal of toxic or hazardous substances. We may also be subject to other present and possible future local, state, federal and foreign regulations.

Our research, development and manufacturing processes involve the controlled use of certain hazardous materials. We are subject to federal, state and local laws and regulations governing the use, manufacture, storage, handling and disposal of such materials and certain waste products. Although we believe that our safety procedures for handling and disposing of such materials comply with the standards prescribed by such laws and regulations, the risk of accidental contamination or injury from these materials cannot be completely eliminated. In the event of such an accident, we could be held liable for any damages that result and any such liability could exceed our resources. Although we believe that we are in compliance in all material respects with applicable environmental laws and regulations, there can be no assurance that we will not incur significant costs to comply with environmental laws and regulations in the future, nor that our operations, business or assets will not be materially adversely affected by current or future environmental laws or regulations.

## PATENTS AND INTELLECTUAL PROPERTY

We pursue a policy of seeking patent protection of our technology, products and product improvements both in the United States and in selected foreign countries. When determined appropriate, we have and plan to continue to enforce and defend our patent rights. In general, however, we do not rely on our patent estate to provide us with any significant competitive advantages. We rely upon trade secrets and continuing technological innovations to develop and maintain our competitive position. We continue to develop a substantial database of information concerning our research and development. We have taken security measures to protect our data and are in the process of exploring ways to enhance further the security of our data. In an effort to protect our trade secrets, we have a policy of requiring our employees, consultants and advisors to execute proprietary information and invention assignment agreements upon commencement of employment or consulting relationships with us. These agreements provide that all confidential information developed or made known to the individual during the course of their relationship with us must be kept confidential, except in specified circumstances.

## COMPETITION

The largest competitors of Integra NeuroSciences in the neurosurgery markets are the PS Medical division of Medtronic, Inc., the Codman division of Johnson & Johnson, the Valleylab division of Tyco International Ltd., and NMT Neurosciences, a division of NMT Medical, Inc. In addition, various of the Integra NeuroSciences product lines compete with smaller specialized companies or larger companies that do not otherwise focus on neurosurgery. The products of Integra LifeSciences face diverse and broad competition, depending on the market addressed by the product. In addition, certain companies are known to be competing particularly in the area of skin substitution or regeneration, including Organogenesis and Advanced Tissue Sciences. Finally, in certain cases competition consists primarily of current medical practice, rather than any particular product (such as autograft tissue as a substitute for INTEGRA(R) Artificial Skin). Depending on the product line, we compete on the basis of our products features, strength of our sales organization or marketing partner, sophistication of our technology, and cost effectiveness of our solution to the customer's medical requirements.

## EMPLOYEES

At December 31, 1999, we had approximately 450 full-time employees engaged in production and production support (including warehouse, engineering, and facilities personnel), quality assurance/quality control, research and development, regulatory and clinical affairs, sales/marketing and administration and finance. None of our current employees are subject to a collective bargaining agreement.

## RECENT DEVELOPMENTS

In March 2000, we agreed to acquire from NMT Medical, Inc. ("NMT") the Selector(R) Ultrasonic Aspirator, Ruggles(TM) Surgical Instrumentation and Spembly Medical Cryosurgery product lines, including certain assets and liabilities, for an acquisition price of $12.0 million. The acquisition is expected to close by April 15, 2000. One of our subsidiaries will acquire the Selector(R) Ultrasonic Aspirator and Spembly Medical Cryosurgery product lines through the purchase of the stock of certain of NMT's subsidiaries, each organized under the laws of the United Kingdom. In addition, one of our subsidiaries will acquire related assets located in the United States, as well as the inventory, customer list and certain other assets of the Ruggles(TM)line of instruments for the neurosurgeon.

The Selector(R) Ultrasonic Aspirator products and the Ruggles(TM) surgical instruments will be sold through Integra NeuroSciences, and the Spembly Medical Cryosurgery products will be sold through Integra LifeSciences. The Selector(R) Ultrasonic Aspirator uses very high frequency sound waves to pulverize cancer tumors, and allows the surgeon to remove the damaged tumor tissue by aspiration. The Ruggles(TM) line of surgical instruments complements and supplements our Redmond(TM) instruments line, but has historically had significantly higher revenues. Finally, the Spembly Medical Cryosurgery products allow surgeons to use low temperatures to more easily extract diseased tissue.

We also acquired the manufacturing facility in Andover, England that manufactures the ultrasonic aspirator and cryosurgery products. The Andover facility employs approximately 65 employees. The Ruggles(TM) instruments are purchased from various manufacturers and resold under the Ruggles(TM) brand name.

## SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

We have made statements in this report, including statements under "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Business," which constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements are made pursuant to the safe harbor provisions of the Securities Litigation Reform Act of 1995 and are subject to a number of risks, uncertainties and assumptions about Integra, including, among other things:

- general economic and business conditions, both nationally and in our international markets;
- our expectations and estimates concerning future financial performance, financing plans and the impact of competition;
- anticipated trends in our business;
- existing and future regulations affecting our business;
- our ability to obtain additional debt and equity financing to fund capital expenditures and working capital requirements;
- our ability to complete acquisitions and integrate and manage new businesses; and
- other risk factors described below under "Risk Factors."

You can identify these forward-looking statements by forward-looking words such as "believe," "may," "could," "will," "estimate," "continue," "anticipate," "intend," "seek," "plan," "expect," "should," "would" and similar expressions in this report.

We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. In light of these risks and uncertainties, the forward-looking events and circumstances discussed in this report may not occur and actual results could differ materially from those anticipated or implied in the forward-looking statements.

## RISK FACTORS

The Company believes that the following important factors, among others, have affected, and in the future could affect, the Company's business and results of operations and could cause the Company's future results to differ materially from its historical results and those expressed in any forward-looking statements made by the Company. Such factors are not meant to represent an exhaustive list of the risks and uncertainties associated with the Company's business. These factors as well as other factors may affect the Company's future results and the Company's stock price, particularly on a quarterly basis.

We expect to continue to incur operating losses and may never achieve profitability.

To date, we have experienced significant operating losses in funding the research, development, manufacturing and marketing of our products and may continue to incur operating losses. At December 31, 1999, we had a cumulative deficit of $94.3 million. Our ability to achieve profitability depends in part upon our ability, either independently or in collaboration with others, to successfully manufacture and market our products and services. There can be no assurance that we will ever achieve a profitable level of operations or that profitability, if achieved, can be sustained on an ongoing basis.

We may be unable to raise necessary additional financing.

We may need to raise additional funds in the future in order to implement our business plan, to conduct research and development, to fund marketing programs or to acquire complementary businesses, technologies or services. Our committed sources of capital are limited. Any required additional financing may be unavailable on terms favorable to us, or at all. If we raise additional funds by issuing equity securities, our stockholders may experience significant dilution of their ownership interest and these securities may have rights senior to those of the holders of our common stock. If additional financing is not available when required or is not available on acceptable terms, we may be unable to fund our expansion, develop or enhance our products and services, take advantage of business opportunities or respond to competitive pressures.

Our operating results may fluctuate from time to time, which could affect the value of our common stock.

Our operating results have fluctuated in the past and can be expected to fluctuate from time to time in the future. Some of the factors that may cause these fluctuations include:

- the impact of acquisitions;
- the timing of significant customer orders;
- market acceptance of our existing products, as well as products in development;
- the timing of regulatory approvals;
- the timing of payments received under collaborative arrangements and strategic alliances;
- our ability to manufacture our products efficiently; and
- the timing of our research and development expenditures.

The industry and market segments in which we operate are highly competitive, and we may not be able to compete effectively with other companies with greater financial resources than we have.

In general, the medical technology industry is characterized by intense competition. We compete with established pharmaceutical and medical technology companies. Competition also comes from early stage companies that have alternative technological solutions for our primary clinical targets, as well as universities, research institutions and other non-profit entities. Many of our competitors have access to greater financial, technical, research and development, marketing, manufacturing, sales, distribution, services and other resources than we do. Further, our competitors may be more effective at implementing their technologies to develop commercial products.

Our competitive position will depend on our ability to achieve market acceptance for our products, implement production and marketing plans, secure regulatory approval for products under development, obtain patent protection and secure adequate capital resources. We may need to develop new applications for our products to remain competitive. Our present or future products could be rendered obsolete or uneconomical by technological advances by one or more of our current or future competitors. Our future success will depend upon our ability to compete effectively against current technology as well as to respond effectively to technological advances. We can not assure you that competitive pressures will not adversely affect our profitability.

Our current strategy involves growth through acquisitions, which require us to incur substantial costs and potential liabilities for which we may never realize the anticipated benefits.

In addition to internal growth, our current strategy involves growth through acquisitions. There can be no assurance that we will be able to continue to implement our growth strategy, or that this strategy will ultimately be successful. A significant portion of our growth in net revenue has resulted from, and is expected to continue to result from, the acquisition of businesses complementary to our own. We engage in evaluations of potential acquisitions and are in various stages of discussion regarding possible acquisitions, certain of which, if consummated, could be significant to us. Acquisitions by us may result in significant transaction expenses, increased interest and amortization expense, increased depreciation expense and increased operating expense, any of which could have a material adverse effect on our operating results. As we grow by acquisitions, we must be able to integrate and manage the new businesses to realize economies of scale and control costs. In addition, acquisitions involve other risks, including diversion of management resources otherwise available for ongoing development of our business and risks associated with entering new markets with which our marketing and sales force has limited experience or where experienced distribution alliances are not available. Our future profitability will depend in part upon our ability to further develop our resources to adapt to the particulars of such new products or business areas and to identify and enter into satisfactory distribution networks. We may not be able to identify suitable acquisition candidates in the future, obtain acceptable financing or consummate any future acquisitions. Any failure by us to integrate acquired operations, manage the cost of providing our products or price our products appropriately may have a material adverse effect on our operating results. In addition, as a result of our acquisitions of other healthcare businesses, we may be subject to the risk of unanticipated business uncertainties or legal liabilities relating to such acquired businesses for which we may not be indemnified by the sellers of the acquired businesses. Future acquisitions may also result in potentially dilutive issuances of equity securities.

To market our products under development we will first need to obtain regulatory approval. Further, if we fail to comply with the extensive governmental regulations that affect our business, we could be subject to penalties and could be precluded from marketing our products.

Our research and development activities and the manufacturing, labeling, distribution and marketing of our existing and future products are subject to regulation by numerous governmental agencies in the United States and in other countries. The FDA and comparable agencies in other countries impose mandatory procedures and standards for the conduct of clinical trials and the production and marketing of products for diagnostic and human therapeutic use. The FDA and other regulatory authorities require that our products be manufactured according to rigorous standards. These regulatory requirements may

significantly increase our production or purchasing costs and may even prevent us from making or obtaining our products in amounts sufficient to meet market demand. If we, or a third party manufacturer, change our approved manufacturing process, the FDA will require a new approval before that process could be used. Failure to develop our manufacturing capability may mean that even if we develop promising new products, we may not be able to produce them profitably, as a result of delays and additional capital investment costs. Manufacturing facilities, both international and domestic, are also subject to inspections by or under the authority of the FDA.

Our products under development are subject to approval by the FDA prior to marketing for commercial use. The process of obtaining necessary FDA approvals can take years and is expensive and full of uncertainties. Our inability to obtain required regulatory approval on a timely or acceptable basis could harm our business. Further, approval may place substantial restrictions on the indications for which the product may be marketed or to whom it may be marketed. To gain approval for the use of a product for clinical indications other than those for which the product was initially evaluated or for significant changes to the product, further studies, including clinical trials and FDA approvals are required. In addition, for products with an approved PMA application, the FDA requires postapproval reporting and may require postapproval surveillance programs to monitor the product's safety and effectiveness. Results of post approval programs may limit or expand the further marketing of the product.

Approved products are subject to continuing FDA requirements relating to quality control and quality assurance, maintenance of records and documentation and labeling and promotion of medical devices. In addition, failure to comply with applicable regulatory requirements could subject us to enforcement action, including product seizures, recalls, withdrawal of clearances or approvals, restrictions on or injunctions against marketing our product or products based on our technology, and civil and criminal penalties.

Medical device laws and regulations are also in effect in many countries outside the United States. These range from comprehensive device approval requirements for some or all of our medical device products to requests for product data or certifications. The number and scope of these requirements are increasing. The requirements governing the conduct of clinical trials and product approvals vary widely from country to country. Failure to comply with applicable federal, state and foreign medical device laws and regulations would result in fines or other censures or preclude our ability to market products. Because approximately 25% of our 1999 revenues are derived from international sales, any delay or withdrawal of approval or change in international regulations could have an adverse effect on our revenues and profitability. See "Business -- Government Regulation."

Lack of market acceptance for our products or market preference for technologies which compete with our products would reduce our revenues and profitability.

We cannot be certain that our current products, or any other products that we develop or market, will achieve or maintain market acceptance. Certain of the medical indications that can be treated by our devices can also be treated by other medical devices. Currently, the medical community widely accepts many alternative treatments, and these other treatments have a long history of use. We cannot be certain that our devices and procedures will be able to replace such established treatments or that either physicians or the medical community in general will accept and utilize our devices or any other medical products that we may develop. In addition, our future success depends, in part, on our ability to develop additional products. Even if we determine that a product candidate has medical benefits, the cost of commercializing that product candidate may be too high to justify development. In addition, competitors may develop products that are more effective, cost less, or are ready for commercial introduction before our products. If we are unable to develop additional, commercially viable products, our future prospects will be adversely affected.

Market acceptance of our products depends on many factors, including our ability to convince prospective collaborators and customers that our technology is an attractive alternative to other technologies, manufacture products in sufficient quantities and at an acceptable cost and place and service, directly, or through our strategic alliances, sufficient quantities of our products. In addition, our technology could be harmed by limited funding available for product and technology acquisitions by our customers, as well as internal obstacles to customer approvals of purchases of our products. The industry is subject to rapid and continuous change arising from, among other things, consolidation and technological improvements. One or more of these factors may vary unpredictably, which could materially adversely affect our competitive position. We may not be able to compete effectively or adjust our contemplated plan of development to meet changing market conditions.

Our business depends significantly on key relationships with third parties which we may not be able to establish and maintain.

Our revenue stream and our business strategy depend in part on our entering into and maintaining collaborative or alliance agreements with third parties concerning product marketing as well as research and development programs. Our ability to enter into agreements with collaborators depends in part on convincing them that our technology can help achieve and accelerate their goals and strategies. This may require substantial time, effort and expense on our part with no guarantee that a strategic relationship will result. We may not be able to establish or maintain these relationships on commercially acceptable terms. Our future agreements may not ultimately be successful. Even if we enter into collaborative or alliance agreements, our collaborators could terminate these agreements or they could expire before meaningful developmental milestones are reached. The termination or expiration of any of these relationships could have a material adverse effect on our business.

Much of the revenue that we may receive under these collaborations will depend upon our collaborators' ability to successfully commercially introduce, market and sell new products derived from our products. Our success depends in part upon the performance by these collaborators of their responsibilities under these agreements.

Some collaborators may not perform their obligations as we expect. Some of the companies we currently have alliances with or are targeting as potential alliances offer products competitive with our products or may develop competitive production technologies or competitive products outside of their collaborations with us that could have a material adverse effect on our competitive position. In addition, our role in the collaborations is mostly limited to the production aspects.

As a result, we may also be dependent on collaborators for other aspects of the development, preclinical and clinical testing, regulatory approval, sales, marketing and distribution of our products. If our current or future collaborators do not effectively market our products or develop additional products based on our technology, our revenues from sales and royalties will be significantly reduced.

The intellectual property rights we rely upon to protect the technology underlying our products may not be adequate, which could enable third parties to use our technology or very similar technology and could reduce our ability to compete in the market.

Our ability to compete effectively will depend, in part, on our ability to maintain the proprietary nature of our technologies and manufacturing processes, which includes the ability to obtain, protect and enforce patents on our technology and to protect our trade secrets. You should not rely on our patents to provide us with any significant competitive advantage. Others may challenge our patents and, as a result, our patents could be narrowed, invalidated or rendered unenforceable. Competitors may develop products similar to ours which are not covered by our patents. In addition, our current and future patent applications may not result in the issuance of patents in the United States or foreign countries. Further, there is a substantial backlog of patent applications at the U.S. Patent and Trademark Office, and the approval or rejection of patent applications may take several years.

Our success will depend partly on our ability to operate without infringing or misappropriating the proprietary rights of others.

We may be sued for infringing the intellectual property rights of others. In addition, we may find it necessary, if threatened, to initiate a lawsuit seeking a declaration from a court that we do not infringe the proprietary rights of others or that these rights are invalid or unenforceable. If we do not prevail in any litigation, in addition to any damages we might have to pay, we would be required to stop the infringing activity or obtain a license. Any required license may not be available to us on acceptable terms, or at all. In addition, some licenses may be nonexclusive, and therefore, our competitors may have access to the same technology licensed to us. If we fail to obtain a required license or are unable to design around a patent, we may be unable to sell some of our products, which could have a material adverse affect on our business, financial condition and results of operations.

We may be involved in lawsuits to protect or enforce our intellectual property rights, which may be expensive.

In order to protect or enforce our intellectual property rights, we may have to initiate legal proceedings against third parties, such as infringement suits or interference proceedings. Intellectual property litigation is costly, and, even if we prevail, the cost of such litigation could affect our profitability. In addition, litigation is time consuming and could divert management attention and resources away from our business. We may also provoke these third parties to assert claims against us.

Our competitive position is dependent in part upon unpatented trade secrets, which we may not be able to protect.

Our competitive position is also dependent upon unpatented trade secrets. Trade secrets are difficult to protect. We can not assure you that others will not independently develop substantially equivalent proprietary information and techniques or otherwise gain access to our trade secrets, that such trade secrets will not be disclosed, or that we can effectively protect our rights to unpatented trade secrets.

In an effort to protect our trade secrets, we have a policy of requiring our employees, consultants and advisors to execute proprietary information and invention assignment agreements upon commencement of employment or consulting relationships with us. These agreements provide that all confidential information developed or made known to the individual during the course of their relationship with us must be kept confidential, except in specified circumstances. There can be no assurance, however, that these agreements will provide meaningful protection for our trade secrets or other proprietary information in the event of the unauthorized use or disclosure of confidential information.

We are exposed to a variety of risks relating to international sales, including fluctuations in exchange rates, commercial unavailability of, and/or governmental restrictions on access to, foreign exchange and delays in collection of accounts receivable.

We generate significant sales outside the United States, a substantial portion of which are conducted with customers who generate revenue in currencies other than the U.S. dollar. As a result, currency fluctuations between the U.S. dollar and the currencies in which such customers do business may impact the demand for our products in foreign countries where the U.S. dollar has increased compared to the local currency. We cannot predict the effects of exchange rate fluctuations upon our future operating results because of the number of currencies involved, the variability of currency exposure and the potential volatility of currency exchange rates.

As a result of the announced acquisition of the NMT businesses, we will generate revenues and incur operating expenses in British pounds sterling. To the extent that we are unable to pay all of such operating expenses with revenues generated in British pounds sterling or are required to exchange revenues generated in British pounds sterling into U.S. dollars, we will experience currency exchange risk with respect to such British pounds sterling denominated revenues or expenses.

Changes in the health care industry may require us to decrease the selling price for our products or could result in a reduction in the size of the market for our products, and limit the means by which we may discount our products, each of which could have a negative impact on our financial performance.

Trends toward managed care, health care cost containment, and other changes in government and private sector initiatives in the United States and other countries in which we do business are placing increased emphasis on the delivery of more cost-effective medical therapies which could adversely affect the sale and/or the prices of our products. For example:

- major third-party payors of hospital services, including Medicare, Medicaid and private health care insurers, have substantially revised their payment methodologies during the last few years which has resulted in stricter standards for reimbursement of hospital charges for certain medical procedures;
- Medicare, Medicaid and private health care insurer cutbacks could create downward price pressure in the cardiac resuscitation pre-hospital market;
- proposals were adopted recently that will change the reimbursement procedures for the capital expenditure portion of the cost of providing care to Medicare patients;
- numerous legislative proposals have been considered that would result in major reforms in the U.S. health care system that could have an adverse effect on our business;
- there has been a consolidation among health care facilities and purchasers of medical devices in the United States who prefer to limit the number of suppliers from whom they purchase medical products, and these entities may decide to stop purchasing our products or demand discounts on our prices;
- there is economic pressure to contain health care costs in international markets;
- there are proposed and existing laws and regulations in domestic and international markets regulating pricing and profitability of companies in the health care industry; and
- there have been recent initiatives by third party payors to challenge the prices charged for medical products which could affect our ability to sell products on a competitive basis.

Both the pressure to reduce prices for our products in response to these trends and the decrease in the size of the market as a result of these trends could adversely affect our levels of revenues and profitability of sales, which could have a material adverse effect on our business.

In addition, there are laws and regulations that regulate the means by which companies in the health care industry may compete by discounting the prices of their products. Although we exercise care in structuring our customer discount arrangements to comply with such laws and regulations, there can be no assurance that (1) government officials charged with responsibility for enforcing such laws will not assert that such customer discount arrangements are in violation of such laws or regulations, or (2) government regulators or courts will interpret such laws or regulations in a manner consistent with our interpretation.

Our dependence on suppliers for materials could impair our ability to manufacture our products.

Outside vendors, some of whom are sole-source suppliers, provide key components and raw materials used in the manufacture of our products. Although we believe that alternative sources for these components and raw materials are available, any supply interruption in a limited or sole source component or raw material could harm our ability to manufacture our products until a new source of supply is identified and qualified. In addition, an uncorrected defect or supplier's variation in a component or raw material, either unknown to us or incompatible with our manufacturing process, could harm our ability to manufacture products. We may not be able to find a sufficient alternative supplier in a reasonable time period, or on commercially reasonable terms, if at all, and our ability to produce and supply our products could be impaired.

If any of our manufacturing facilities were damaged and/or our manufacturing processes interrupted, we could experience lost revenues and our business could be seriously harmed.

We manufacture our products in a limited number of facilities. Damage to our manufacturing, development or research facilities due to fire, natural disaster, power loss, communications failure, unauthorized entry or other events could cause us to cease development and manufacturing of some or all of our products.

We may have significant product liability exposure and our insurance may not cover all potential claims.

We face an inherent business risk of exposure to product liability and other claims in the event that our technologies or products are alleged to have caused harm. We may not be able to obtain insurance for such potential liability on acceptable terms with adequate coverage, or at reasonable costs. Any potential product liability claims could exceed the amount of our insurance coverage or may be excluded from coverage under the terms of the policy. Our insurance, once obtained, may not be renewed at a cost and level of coverage comparable to that then in effect.

We are subject to other regulatory requirements relating to occupational health and safety and the use of hazardous substances which may impose significant compliance costs on us.

In addition to the regulatory framework for product approval, manufacturing and marketing, we are and may be subject to regulation under federal and state laws, including requirements regarding occupational health and safety, laboratory practices, and the use, handling and disposal of toxic or hazardous substances. Our research, development and manufacturing processes involve the controlled use of certain hazardous materials. We are subject to federal, state and local laws and regulations governing the use, manufacture, storage, handling and disposal of such materials and certain waste products. Although we believe that our safety procedures for handling and disposing of such materials comply with the standards prescribed by such laws and regulations, the risk of accidental contamination or injury from these materials cannot be completely eliminated. In the event of such an accident, we could be held liable for any damages that result and any such liability could exceed the limits or fall outside the coverage of our insurance and could exceed our resources. We may not be able to maintain insurance on acceptable terms, or at all. We may incur significant costs to comply with environmental laws and regulations in the future. We may also be subject to other present and possible future local, state, federal and foreign regulations.

Future sales of our common stock may depress our stock price.

Sales of our common stock, or the perception that such sales could occur, could cause the market price of our common stock to decline and impair our ability to raise additional capital in the future through the sale of equity securities.

The loss of key personnel could harm our business.

We believe our success depends on the contributions of a number of our key personnel, including Stuart M. Essig, President and Chief Executive Officer of Integra. If we lose the services of key personnel, that loss could materially harm our business. We maintain "key person" life insurance on Mr. Essig. In addition, recruiting and retaining qualified personnel will be critical to our success. There is a shortage in the industry of qualified management and scientific personnel, and competition for these individuals is intense. There can be no assurance that we will be able to attract additional and retain existing personnel.

Our stock price may continue to be highly volatile and our stockholders may not be able to resell their shares at or above the price they paid for them.

The stock market in general, and the stock prices of medical device companies, biotechnology companies and other technology-based companies in particular, have experienced significant volatility that often has been unrelated to the operating performance of and beyond the control of any specific public companies. The market price of Integra common stock has fluctuated widely in the past and is likely to continue to

fluctuate in the future. Factors that may have a significant impact on the market price of Integra common stock include:

- shortfall in our revenues or earnings relative to the levels expected by securities analysts;
- future announcements concerning Integra or its competitors, including the announcement of acquisitions;
- changes in the prospects of our business partners or suppliers;
- developments regarding our patents or other proprietary rights or those of our competitors;
- quality deficiencies in our products;
- competitive developments, including technological innovations by us or our competitors;
- government regulation, including the FDA's review of our products and developments;
- changes in recommendations of securities analysts and rumors that may be circulated about Integra or our competitors;
- public perception of risks associated with our operations;
- conditions or trends in the medical device and biotechnology industries;
- additions or departures of key personnel; and
- sales of our common stock.

Any of these factors could immediately, significantly and adversely affect the trading price of Integra common stock.

We do not intend to pay dividends in the foreseeable future.

We do not anticipate paying any cash dividends on our common stock in the foreseeable future. We intend to retain future earnings to fund our growth. Accordingly, our stockholders will not receive a return on their investment in our common stock through the payment of dividends in the foreseeable future and may not realize a return on their investment even if they sell their shares. As a result, our stockholders may not be able to resell their shares at or above the price they paid for them. Any future payment of dividends to our stockholders will depend on decisions that will be made by our board of directors and will depend on then existing conditions, including our financial condition, contractual restrictions, capital requirements and business prospects.

Our major stockholders could make decisions adverse to the interests of other stockholders.

The Company's directors and executive officers and affiliates of certain directors own or control a majority of the outstanding voting securities of the Company and are generally able to elect all directors, to determine the outcome of corporate actions requiring stockholder approval and otherwise to control the business. Such control could preclude any unsolicited acquisition of Integra and consequently adversely affect the market price of the common stock. Furthermore, we are subject to Section 203 of the Delaware General Corporation Law, which could have the effect of delaying or preventing a change of control.

Year 2000 related system failures or malfunctions could harm our business.

As of the date of this report, our systems have operated without any apparent Year 2000 related problems and appear to be Year 2000 compliant. We are not aware that any of our primary vendors or systems maintained by third parties have experienced significant Year 2000 compliance problems. However, while no such problem has been discovered as of the date of this report, Year 2000 issues may not become apparent immediately and, therefore, Integra may be affected in the future. We will continue to monitor the issue and work to remediate any Year 2000 issues that may arise.

ITEM 2. PROPERTIES

Our principal executive offices are located in Plainsboro, New Jersey. Principal manufacturing and research facilities are located in Plainsboro, New Jersey, San Diego, California and Anasco, Puerto Rico. In addition, we lease several smaller facilities to support additional administrative and storage operations. Our total manufacturing and research space approximates 82,000 square feet. Our Integra LifeSciences products are manufactured in and distributed through the Plainsboro facility. Our Integra NeuroSciences products are manufactured in the Plainsboro, San Diego and Anasco facilities and are distributed through the Plainsboro and San Diego facilities. In March 2000, we leased a warehouse facility in Cranbury, New Jersey that will serve as the national distribution center for all of our products in the United States. In connection with the acquisition of the business, including certain assets and liabilities, of Clinical Neuro Systems in January 2000, we assumed a lease for an FDA registered and inspected manufacturing facility in Exton, Pennsylvania. All of our facilities are leased.

All of our manufacturing and distribution facilities are FDA registered and inspected. We believe that our manufacturing facilities are suitable for their intended purposes and have capacities adequate for current and projected needs for existing products. Some capacity of the plants is being converted, with any needed modification, to meet the current and projected requirements of existing and future products.

ITEM 3. LEGAL PROCEEDINGS

In July 1996, the Company filed a patent infringement lawsuit in the United States District Court in San Diego against Merck KGaA, a German corporation, Scripps Research Institute, a California nonprofit corporation, and David A. Cheresh, Ph.D., a research scientist with Scripps seeking damages and injunctive relief. The complaint charged, among other things, that the defendant Merck KGaA willfully and deliberately induced, and continues to willfully and deliberately induce, defendants Scripps Research Institute and Dr. David A. Cheresh to infringe certain of the Company's patents. These patents are part of a group of patents granted to The Burnham Institute and licensed by the Company that are based on the interaction between a family of cell surface proteins called integrins and the arginine-glycine-aspartic acid (known as "RGD") peptide sequence found in many extracellular matrix proteins. The defendants filed a countersuit asking for an award of defendants' reasonable attorney fees. In March 2000 a jury returned a verdict, finding that Merck KGaA had willfully induced infringement of the Company's patents and awarded the Company $15.0 million in damages, which may be adjusted by the court. The Company expects that post-trial motions will be filed, and that Merck KGaA will appeal various decisions of the court and request a new trial, a reduction in damages, or a judgment as a matter of law notwithstanding the verdict. We cannot accurately predict the ultimate resolution of this matter and have not reflected the verdict in our financial statements.

Bruce D. Butler, Ph.D., Bruce A. McKinley, Ph.D., and C. Lee Parmley (the "Optex Claimants"), each parties to a Letter Agreement (the "Letter Agreement") with Camino NeuroCare, Inc. ("Camino") dated as of December 18, 1996, have alleged that Camino breached the terms of the Letter Agreement prior to our acquisition of the NeuroCare Group (Camino's prior parent company). The Letter Agreement contains arbitration provisions and Integra and the Optex Claimants have agreed to negotiate rather than seek arbitration for a limited time. While we believe that Camino has valid legal and factual defenses, the Optex Claimants have asserted unspecified significant damages, and we believe that the Optex Claimants are likely to pursue arbitration under the Letter Agreement if the matter is not settled otherwise. We cannot predict the outcome of such an arbitration, were it to take place. In addition, we have asserted a

right to indemnification from the seller of the NeuroCare businesses, but there can be no assurance that indemnification, if any, will be obtained.

The Company is also subject to other claims and lawsuits in the ordinary course of its business. In the opinion of management, such other claims are either adequately covered by insurance or otherwise indemnified, and are not expected, individually or in the aggregate, to result in a material adverse effect on the financial condition of the Company. The Company's financial statements do not reflect any material amounts related to possible unfavorable outcomes of the matters above or others. However, it is possible that the Company's results of operations, financial position and cash flows in a particular period could be materially affected by these contingencies.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders during the fourth quarter of the fiscal year covered by this report.

Additional Information:

The following information is furnished in this Part I pursuant to Instruction 3 to Item 401(b) of Regulation S-K.

Executive Officers

The executive officers of the Company serve at the discretion of the Board of Directors. The only family relationship between any of the executive officers and directors of the Company is that Mr. Holtz is the nephew of Richard E. Caruso, Ph.D., who is Chairman of the Company's Board of Directors. The following information indicates the position and age of the Company's executive officers as of the date of this report and their previous business experience.

| Name | Age | Position |
| --- | --- | --- |
| Stuart M. Essig, Ph.D. | 38 | President and Chief Executive Officer |
| George W. McKinney, III, Ph.D. | 56 | Executive Vice President and Chief Operating Officer |
| John B. Henneman, III | 38 | Senior Vice President, Chief Administrative Officer and General Counsel |
| Judith E. O'Grady | 49 | Senior Vice President, Regulatory, Quality Assurance and Clinical Affairs |
| Michael D. Pierschbacher, Ph.D. | 48 | Senior Vice President Research and Development, General Manager, Corporate Research Center |
| David B. Holtz | 33 | Vice President, Finance and Treasurer |

Stuart M. Essig, Ph.D. has served as President and Chief Executive Officer and a director of the Company since December 1997. Before joining the Company, Mr. Essig supervised the medical technology practice at Goldman, Sachs & Co. as a managing director. Mr. Essig had ten years of broad health care experience at Goldman Sachs serving as a senior merger and acquisitions advisor to a broad range of domestic and international medical technology, pharmaceutical and biotechnology clients. Mr. Essig received an A.B. degree from the Woodrow Wilson School of Public and International Affairs at Princeton University and an MBA and a Ph.D. degree in Financial Economics from the University of Chicago, Graduate School of Business. Mr. Essig also serves on the Board of Directors of Vital Signs Incorporated and St. Jude Medical Corporation.

George W. McKinney, III, Ph.D. has served the Company as Vice Chairman, Executive Vice President and Chief Operating Officer since May 1997 and as a member of the Board of Directors since December 1992. Between 1990 and 1997, Dr. McKinney was Managing Director of Beacon Venture Management Corporation, a venture capital firm. Between 1992 and 1997, Dr. McKinney also served as President and Chief Executive Officer of Gel Sciences, Inc. and GelMed, Inc., a privately held specialty materials firm with development programs in both the industrial and medical products fields. From 1983 to 1989, Dr. McKinney was a Managing Director at American Research & Development, a venture capital firm. Between 1986 and 1989, he also served as President and Chief Executive Officer of American Superconductor, Inc., a development stage firm in the specialty materials field. From 1965 to 1983, Dr.

McKinney worked for Corning Glass Works (now Corning, Inc.), a specialty materials firm, in a variety of manufacturing, engineering, and financial positions. At Corning, he served as President of Corning Designs, a subsidiary which he founded, as Secretary to the Management Committee, as Director of Business Development and Planning, as Treasurer, International, as Assistant Treasurer, Domestic, and as Financial and Control Manager for the Engineering Division. Dr. McKinney holds an S.B. in Management from MIT and a Ph.D. in Strategic Planning from Stanford University.

John B. Henneman, III is the Company's Senior Vice President, Chief Administrative Officer and General Counsel. Prior to joining the Company in August 1998, Mr. Henneman served Neuromedical Systems, Inc., a public company developer and manufacturer of in vitro diagnostic equipment, in various capacities for more than four years. From 1994 until June 1997, Mr. Henneman was Vice President of Corporate Development, General Counsel and Secretary. From June 1997 through November 1997, he served in the additional capacity of interim Co-Chief Executive Officer and from December 1997 to August 1998 Mr. Henneman was Executive Vice President, US Operations, and Chief Legal Officer. In March 1999, Neuromedical Systems, Inc. filed a petition under Chapter 11 of the federal bankruptcy laws. From 1986 to 1994, Mr. Henneman practiced law in the Corporate Department of Latham & Watkins (Chicago, Illinois). Mr. Henneman received his A.B. (Politics) from Princeton University in 1983 and his J.D. from the University of Michigan Law School in 1986.

Judith E. O'Grady, Senior Vice President of Regulatory Affairs, Quality Assurance and Clinical Research, has served the Company since 1985. Ms. O'Grady has worked in the areas of medical devices and collagen technology for over 20 years. Prior to joining the Company, Ms. O'Grady worked for Colla-Tec, Inc., a Marion Merrell Dow Company. During her career Ms. O'Grady has held positions with Surgikos, a Johnson & Johnson company, and was on the faculty of Boston University College of Nursing and Medical School. Ms. O'Grady obtained the FDA approval for INTEGRA(R) Artificial Skin, the first regenerative product approved by the FDA. She also has obtained approvals for several other product lines for the Company. In addition, Ms. O'Grady obtained the CE Mark Certification for approvals in the European Union as well as a multitude of other international approvals. She has been pivotal in the ISO 9001 Certification of the Company. She is a member of the NIST group on standards for clinical outcomes as well as on the Board of Directors for the New Jersey League of Nursing. Ms. O'Grady has presented professional programs and lectures, both nationally and internationally. She received her BS degree from Marquette University and MSN in Nursing from Boston University.

Michael D. Pierschbacher, Ph.D. joined the Company in October 1995 as Senior Vice President, Research and Development. In May 1998 he was named Senior Vice President and Director of the Corporate Research Center. From June 1987 to September 1995, Dr. Pierschbacher served as Senior Vice President and Scientific Director of Telios Pharmaceuticals, Inc. ("Telios") which was acquired by the Company in connection with the reorganization of Telios under Chapter 11 of the federal bankruptcy code. He was a co-founder of Telios in May 1987 and is the co-discoverer and developer of Telios' matrix peptide technology. Before joining Telios as a full-time employee in October 1988, he was a staff scientist at the Burnham Institute for five years and remained on staff there in an adjunct capacity until the end of 1997. He received his post-doctoral training at Scripps Clinical and Research Foundation and at the Burnham Institute. Dr. Pierschbacher received his Ph.D. in Biochemistry from the University of Missouri.

David B. Holtz joined the Company as Controller in 1993 and has served as Vice President, Finance and Treasurer since March 1997. His responsibilities include managing all accounting and information systems functions. Before joining the Company, Mr. Holtz was an associate with Coopers & Lybrand, L.L.P. in Philadelphia and Cono Leasing Corporation, a private leasing company. He received a BS degree in Business Administration from Susquehanna University in 1989 and has been certified as a public accountant.

PART II

## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company's Common Stock trades on The Nasdaq National Market under the symbol "IART". The following table represents the high and low sales prices for the Company's Common Stock for each quarter for the last two years. All outstanding common share and per share amounts have been retroactively adjusted to reflect a one-for-two reverse stock split of the Company's Common Stock on May 18, 1998.

| | HIGH | LOW |
|---|---|---|
| 1999 | | |
| First Quarter | $5.188 | $3.00 |
| Second Quarter | $7.50 | $3.875 |
| Third Quarter | $10.375 | $5.625 |
| Fourth Quarter | $6.4375 | $5.375 |
| 1998 | | |
| First Quarter | $10.75 | $8.125 |
| Second Quarter | $9.75 | $6.125 |
| Third Quarter | $8.00 | $4.375 |
| Fourth Quarter | $5.25 | $3.25 |

The closing price for the Common Stock on March 24, 2000 was $14.75. For purposes of calculating the aggregate market value of the shares of Common Stock of the Company held by non-affiliates, as shown on the cover page of this report, it has been assumed that all the outstanding shares were held by non-affiliates except for the shares held by directors and executive officers of the Company and stockholders owning 10% or more of outstanding shares. However, this should not be deemed to constitute an admission that all such persons are, in fact, affiliates of the Company. Further information concerning ownership of the Company's Common Stock by executive officers, directors and principal stockholders will be included in the Company's definitive proxy statement to be filed with the Securities and Exchange Commission.

The Company does not currently pay any cash dividends on its Common Stock and does not anticipate paying as such dividends in the foreseeable future.

The number of stockholders of record as of March 24, 2000 was approximately 850, which includes stockholders whose shares were held in nominee name. The number of beneficial stockholders at that date was over 6,700.

ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth consolidated financial data with respect to the Company for each of the five years in the period ended December 31, 1999. The information set forth below should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the Company's consolidated financial statements and related notes included elsewhere in this report.

| In thousands, except per share data | Years Ended December 31, 1999 | 1998 | 1997 | 1996 | 1995 |
|---|---|---|---|---|---|
| Statement of Operations Data (1) | | | | | |
| Product sales | $ 39,661 | $ 14,076 | $ 14,001 | $ 11,210 | $ 8,356 |
| Other revenue | 2,829 | 3,379 | 745 | 1,938 | 1,873 |
| Total revenue | 42,490 | 17,455 | 14,746 | 13,148 | 10,229 |
| Cost of product sales, including depreciation(2) | 22,219 | 7,420 | 7,027 | 6,671 | 4,850 |
| Research and development | 8,670 | 8,238 | 6,222 | 6,064 | 5,104 |
| Selling and marketing | 9,481 | 5,953 | 5,458 | 4,304 | 2,455 |
| General and administrative (3) | 12,682 | 9,357 | 14,430 | 4,881 | 3,225 |
| Amortization and other depreciation | 1,818 | 667 | 520 | 675 | 504 |
| Acquired in-process research and development (4) | -- | -- | -- | -- | 19,593 |
| Total costs and expenses | 54,870 | 31,635 | 33,657 | 22,595 | 35,731 |
| Operating loss | (12,380) | (14,180) | (18,911) | (9,447) | (25,502) |
| Interest income | 1,006 | 1,250 | 1,771 | 1,799 | 283 |
| Interest expense | (712) | -- | -- | -- | (188) |
| Gain on disposition of product line | 4,161 | -- | -- | -- | -- |
| Other income | 141 | 588 | 176 | 120 | 5 |
| Net loss before income taxes | (7,784) | (12,342) | (16,964) | (7,528) | (25,402) |
| Income tax benefit (5) | 1,818 | -- | -- | -- | -- |
| Net loss | $ (5,966) | $(12,342) | $(16,964) | $ (7,528) | $(25,402) |
| Basic and diluted net loss per share | $ (.40) | $ (.77) | $ (1.15) | $ (.54) | $ (2.41) |
| Weighted average common shares outstanding | 16,802 | 16,139 | 14,810 | 14,057 | 10,536 |

| In thousands | December 31, 1999 | 1998 | 1997 | 1996 | 1995 |
|---|---|---|---|---|---|
| Balance Sheet Data (1) | | | | | |
| Cash, cash equivalents and short-term investments | $ 23,612 | $ 20,187 | $ 26,272 | $ 34,276 | $ 5,710 |
| Working capital | 28,014 | 23,898 | 29,407 | 37,936 | 7,476 |
| Total assets | 66,253 | 34,707 | 38,356 | 48,741 | 19,378 |
| Long-term debt | 7,625 | -- | -- | -- | -- |
| Accumulated deficit | (94,304) | (88,287) | (75,945) | (58,981) | (51,453) |
| Total stockholders' equity | 37,989 | 31,366 | 35,755 | 46,384 | 17,427 |

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(1) As the result of the Company's acquisitions of Telios Pharmaceuticals, Inc. ("Telios") in August 1995, Rystan Company, Inc. ("Rystan") in September 1998 and the NeuroCare group of companies ("NeuroCare") in March 1999, the consolidated financial results and balance sheet data for certain of the periods presented above may not be directly comparable.

(2) The 1999 and 1998 cost of product sales include $2.4 million and $0.3 million, respectively, of fair value purchase accounting adjustments related to inventory acquired in the NeuroCare and Rystan acquisitions.

(3) The 1997 general and administrative expense included the following two non-cash charges: (i) $1.0 million related to an asset impairment charge; and (ii) $5.9 million related to an equity-based signing bonus for the Company's President and Chief Executive Officer.

(4) As a result of purchase accounting, the 1995 loss included $19.6 million of acquired in-process research and development which was charged to expense at the date of the Company's acquisition of Telios.

(5) The 1999 income tax benefit includes a non-cash benefit of $1.8 million resulting from the reduction of the deferred tax liability recorded in the NeuroCare acquisition to the extent that consolidated deferred tax assets were generated subsequent to the acquisition.

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the Company's consolidated financial statements, the notes thereto and the other financial information included elsewhere in this report.

### General

The Company develops, manufactures and markets medical devices, implants and biomaterials. The Company's operations consist of (1) Integra NeuroSciences, which is a leading provider of implants, instruments, and monitors used in neurosurgery, neurotrauma, and related critical care and (2) Integra LifeSciences, which develops and manufactures a variety of medical products and devices, including products based on our proprietary tissue regeneration technology which are used to treat soft tissue and orthopedic conditions. Integra NeuroSciences sells primarily through a direct sales organization and Integra LifeSciences sells primarily through strategic alliances and distributors.

In 1999, the Company initiated a repositioning of its business to selectively focus on attractive niche markets. Implementation of this strategy included the purchase of the NeuroCare Group of companies ("NeuroCare") in March 1999 and the execution of an agreement (the "JJM Agreement") with Johnson & Johnson Medical, Division of Ethicon, Inc. ("JJM") that provides JJM with exclusive marketing and distribution rights to INTEGRA(R) Artificial Skin worldwide, excluding Japan. As a result of these transactions, the Company formed its Integra NeuroSciences segment and reorganized the remainder of the Company's products into its Integra LifeSciences segment. The JJM Agreement allowed the Integra LifeSciences segment to focus on strategic collaborative initiatives. A majority of the products in the Integra NeuroSciences segment, which accounted for 54% of the Company's total revenues in 1999, were acquired in the NeuroCare acquisition. The Integra LifeSciences segment, which accounted for 46% of the Company's total revenues in 1999, now operates as a provider of innovative products and development activities through strategic alliances with marketing partners and distributors. As a result of these activities, the Company's segment financial results for each of the years 1999, 1998 and 1997 may not be directly comparable.

The Company has incurred losses from operations since its inception and will continue to incur such losses unless and until product sales and research and collaborative arrangements generate sufficient revenue to fund continuing operations. As of December 31, 1999, the Company had an accumulated deficit of $94.3 million.

The Company's financial information discussed below should be considered in light of the following transactions/events that occurred subsequent to December 31, 1999:

- The Company acquired the business, including certain assets and liabilities, of Clinical Neuro Systems ("CNS") on January 17, 2000 for $6.8 million. CNS designs, manufactures and sells neurosurgical external ventricular drainage systems including catheters and drainage bags, as well as cranial access kits. The consideration for the CNS acquisition consisted of $4.0 million in cash and a two-year $2.8 million note payable to the seller.

- On March 21, 2000, the Company agreed to acquire the Selector(R) Ultrasonic Aspirator, Ruggles(TM) hand-held neurosurgical instruments and cryosurgery product lines, including certain assets and liabilities, from NMT Medical, Inc. for $12.0 million in cash. The completion of this transaction is subject to customary closing conditions and is expected to close early in the second quarter of 2000.

- On March 29, 2000, the Company issued 54,000 shares of Series C Preferred Stock ("Series C Preferred") and warrants to purchase 300,000 shares of common stock at $9.00 per share to affiliates of Soros Private Equity Partners LLC, resulting in proceeds to the Company of $5.4 million. The Series C Preferred is convertible into 600,000 shares of our common stock and has a liquidation preference of $5.4 million with a 10% cumulative dividend. The Series C Preferred was issued with a beneficial conversion feature that resulted in a nonrecurring non-cash dividend of $4.2 million that will be reflected in earnings (loss) per share applicable to common stock in the first quarter of 2000.

See Note 20 to the Company's consolidated financial statements under Item 8 of this report for additional information.

Results of Operations

1999 Compared to 1998

Overall, the Company's net loss decreased from $12.3 million in 1998 to $6.0 million in 1999. Operating results improved $1.8 million in 1999, with an operating loss of $12.4 million in 1999 as compared to a $14.2 million operating loss in 1998. The improvement in 1999 operating results resulted from the successful integration of the NeuroCare acquisition and implementation of the JJM Agreement, cost savings achieved in all business segments as compared to 1998 spending levels, and sales increases in the Company's Integra LifeSciences product lines. The Company also recognized a non-operating gain of $4.2 million from the sale of a product line in January 1999 and $1.8 million of non-cash deferred tax benefits recorded in 1999 subsequent to the NeuroCare acquisition.

Total revenues increased $25.0 million from $17.5 million in 1998 to $42.5 million in 1999 primarily as a result of the NeuroCare acquisition. This increase consists of a $25.6 million increase in product sales, offset by a $0.6 million decrease in other revenue. Product sales and cost of product sales were as follows (in thousands):

| 1999 | Integra NeuroSciences | Integra LifeSciences | Consolidated |
|---|---|---|---|
| Product sales | $ 22,369 | $ 17,292 | $ 39,661 |
| Cost of product sales | 13,192 | 9,027 | 22,219 |
| Gross margin on product sales | 9,177 | 8,265 | 17,442 |
| Gross margin percentage | 41% | 48% | 44% |

| 1998 | Integra NeuroSciences | Integra LifeSciences | Consolidated |
|---|---|---|---|
| Product sales | $ -- | $ 14,076 | $ 14,076 |
| Cost of product sales | -- | 7,420 | 7,420 |
| Gross margin on product sales | -- | 6,656 | 6,656 |
| Gross margin percentage | -- | 47% | 47% |

Consolidated product sales increased $25.6 million to $39.7 million in 1999 primarily as a result of the sales of product lines acquired in 1999 and 1998 and increased sales of Integra LifeSciences products. Consolidated export sales increased $6.8 million to $9.1 million in 1999, primarily as a result of the NeuroCare acquisition.

Consolidated gross margin on product sales during 1999 decreased to 44% of product sales primarily because of the lower gross margins on sales of INTEGRA(R) Artificial Skin and $2.4 million of fair value inventory purchase accounting adjustments related to business acquisitions. Cost of product sales in 1998 included approximately $0.3 million of such fair value inventory purchase accounting adjustments. Excluding these inventory purchase accounting adjustments, consolidated gross margin on product sales would have been 50% and 49% in 1999 and 1998, respectively.

Integra NeuroSciences product sales and cost of product sales were generated from the NeuroCare acquisition in March 1999 and $0.5 million of sales of the DuraGen(TM) Dural Graft Matrix, which the Company launched in the third quarter of 1999. Included in the cost of product sales is $1.9 million of fair value inventory purchase accounting adjustments. Excluding these adjustments, gross margin on Integra NeuroSciences product sales would have been 50% of product sales in 1999.

Integra LifeSciences product sales increased $3.2 million to $17.3 million in 1999 primarily as a result of $3.6 million of sales increases attributable to product lines acquired in connection with business acquisitions and a $1.5 million increase in sales of the Company's hemostasis, dental, and infection control products. These increases were offset by a $2.1 million decrease in sales of INTEGRA(R) Artificial Skin, primarily due to the transfer of all direct sales and marketing efforts to JJM under the JJM Agreement in June 1999. The JJM Agreement requires that JJM make non-refundable payments to the Company each year based upon minimum purchases of INTEGRA(R) Artificial Skin.

Gross margin on Integra LifeSciences product sales increased to 48% of product sales in 1999 primarily because of the higher gross margins associated with the acquired product lines. Offsetting this increase are lower margins associated with the distribution of INTEGRA(R) Artificial Skin through JJM in the second half of 1999 and other INTEGRA(R) Artificial Skin manufacturing and inventory related costs. Gross margin on Integra LifeSciences product sales included $0.5 million and $0.3 million of fair value purchase accounting adjustments in 1999 and 1998, respectively, related to acquired product line sales. Excluding these purchase accounting adjustments, gross margin on Integra LifeSciences product sales would have been 51% and 49% of Integra LifeSciences product sales in 1999 and 1998, respectively. The long-term impact on Integra LifeSciences product sales and related gross margin will depend on required production volumes and our strategic partners' ability to increase sales volume.

Total other revenue decreased $0.6 million in 1999 to $2.8 million. Other revenue in the Integra NeuroSciences segment decreased $0.5 million from $1.0 million in 1998 to $0.5 million in 1999. In 1999, other revenue consisted of $0.5 million of royalty income related to technology acquired in the NeuroCare acquisition. In 1998, other revenue consisted of $1.0 million of revenue from Century Medical, Inc. ("CMI") as partial reimbursement of research and development costs previously expended by the Company. Other revenue in the Integra LifeSciences segment decreased $0.1 million to $2.3 million in 1999. In 1999, other revenue consisted of $0.9 million of grant revenue, $0.9 million of payments received in connection with Integra LifeSciences development programs, $0.3 million of license revenue associated with the JJM Agreement and $0.2 million of royalty income. In 1998, other revenue consisted of $1.0 million of development funding received from DePuy, a Johnson & Johnson Company ("DePuy"), in connection with Integra LifeSciences articular cartilage regeneration development program, $0.6 million of grant revenue, $0.3 million of royalty income and $0.5 million of license revenue.

Research and development expenses were as follows (in thousands):

| | 1999 | 1998 |
|---|---|---|
| Integra NeuroSciences | $2,028 | $ 924 |
| Integra LifeSciences | 6,642 | 7,314 |
| Total | $8,670 | $8,238 |

Research and development expense in the Integra NeuroSciences segment increased $1.1 million to $2.0 million in 1999 primarily because of the NeuroCare acquisition. Integra NeuroSciences research and development activities in 1998 consisted of programs involving the DuraGen(TM) Dural Graft Matrix, which was launched in the third quarter of 1999, and the peripheral nerve guide, a bioabsorbable collagen conduit designed to support guided regeneration of severed nerve tissues. Significant ongoing research and development programs in the Company's Integra NeuroSciences segment include the development of the next generation of intra-cranial pressure monitors and shunting products and the continuation of clinical trials involving the peripheral nerve guide.

Research and development activities within the Integra LifeSciences segment decreased $0.7 million to $6.6 million in 1999 primarily because of the elimination of several research programs in early 1999. Significant ongoing research and development programs in the Company's Integra LifeSciences segment include the Company's articular cartilage regeneration program with DePuy, clinical and development activities related to INTEGRA(R) Artificial Skin, additional applications for the Company's orthopedic technologies and development work being conducted to support the Genetics Institute bone regeneration program. The JJM Agreement will provide the Company with research funding of $2.0 million per year for INTEGRA(R) Artificial Skin beginning in the year 2000.

Approximately 22% of the Company's total research and development expenses in 1999 and 1998 were funded through external grants and development funding programs.

During 1999, the Company began shifting the allocation of research and development expenditures toward the NeuroSciences segment in line with the repositioning of the Company. While the Company anticipates that expenditures for research and development will remain at or above 1999 levels, the allocation between segments and programs and the timing of expenditures will vary depending on various factors, including the timing and outcome of pre-clinical and clinical results, changing competitive conditions, continued program funding levels, potential funding opportunities and determinations with respect to the commercial potential of the Company's technologies.

Selling and marketing expenses were as follows (in thousands):

| | 1999 | 1998 |
|---|---|---|
| Integra NeuroSciences | $6,233 | $ 627 |
| Integra LifeSciences | 3,248 | 5,326 |
| Total | $9,481 | $5,953 |

Integra NeuroSciences selling and marketing expense increased $5.6 million to $6.2 million in 1999 primarily because of the NeuroCare acquisition. Additional increases resulted from expenses related to the domestic and international launch of the DuraGen(TM) Dural Graft Matrix in the third quarter of 1999. The decrease of $2.1 million in Integra LifeSciences selling and marketing expenses to $3.3 million is primarily the result of the transition of INTEGRA(R) Artificial Skin selling and marketing activities to JJM, offset by a slight increase in sales and marketing costs related to acquired product lines.

General and administrative expenses were as follows (in thousands):

| | 1999 | 1998 |
|---|---|---|
| Integra NeuroSciences | $ 4,499 | $ 417 |
| Integra LifeSciences | 2,316 | 1,989 |
| Corporate | 5,867 | 6,951 |
| Total | $12,682 | $ 9,357 |

Integra NeuroSciences general and administrative expense increased $4.1 million to $4.5 million in 1999 primarily because of the NeuroCare acquisition. Included in this amount is $1.0 million of severance costs associated with the closure of NeuroCare's corporate headquarters in July 1999. General and administrative expense in the Integra LifeSciences segment increased $0.3 million to $2.3 million in 1999 primarily due to additional headcount. The decrease of $1.1 million in corporate general and administrative expenses to $5.9 million in 1999 resulted primarily from decreased legal fees and costs associated with maintenance of the Company's intellectual property and the effects of a $0.2 million asset impairment charge recorded in 1998, offset by increases related to additional headcount.

Amortization and other depreciation (excluding $1.2 million and $0.8 million of depreciation included in cost of sales in 1999 and 1998, respectively) were as follows (in thousands):

| | 1999 | 1998 |
|---|---|---|
| Integra NeuroSciences | $1,176 | $ 42 |
| Integra LifeSciences | 345 | 288 |
| Corporate | 297 | 337 |
| Total | $1,818 | $ 667 |

Amortization and other depreciation in the Integra NeuroSciences segment increased to $1.2 million in 1999 as a result of the NeuroCare acquisition. Included in the 1999 amount is $0.8 million of amortization of goodwill and other intangibles and $0.4 million of depreciation. Amortization and other depreciation in the Integra LifeSciences segment consisted almost entirely of depreciation.

Interest income decreased $0.3 million to $1.0 million in 1999 because of lower average cash and investment balances during the year. Interest expense of $0.7 million in 1999 relates to a term loan and credit facility assumed in the NeuroCare acquisition.

The $4.2 million gain on disposition of product line was recorded in connection with the sale of a product line in January 1999.

Other income decreased $0.5 million to $0.1 million in 1999. This decrease was the result of a $0.6 million favorable litigation settlement recorded in 1998.

The income tax benefit of $1.8 million in 1999 consists of a $1.8 million non-cash benefit resulting from the reduction of the deferred tax liability recorded in the NeuroCare acquisition to the extent that consolidated deferred tax assets were generated subsequent to the acquisition and a $0.6 million tax benefit associated with the sale of certain state net operating losses in the fourth quarter of 1999, both of which were offset by $0.6 million of current income tax provisions. No additional income tax benefit is anticipated in connection with the deferred tax liability recorded in the NeuroCare acquisition.

1998 Compared to 1997

The Company's net loss decreased from $17.0 million in 1997 to $12.3 million in 1998. The 1997 loss included two non-cash charges totaling $6.9 million, which were included in general and administrative expense.

Total revenues increased $2.8 million from $14.7 million in 1997 to $17.5 million in 1998, due largely to increases in other revenues. Product sales, all of which were within the Integra LifeSciences segment, increased $0.1 million from $14.0 million in 1997 to $14.1 million in 1998 and included $0.7 million in sales of product lines acquired in the fourth quarter of 1998. Offsetting these increases in sales was the elimination of $0.6 million of sales of discontinued product lines manufactured at the Company's Westchester, Pennsylvania facility, which was closed in January 1998. Consolidated export sales increased $0.3 million to $2.3 million in 1998, primarily as a result of increased international distribution efforts for INTEGRA(R) Artificial Skin. INTEGRA(R) Artificial Skin received CE Mark certification in March 1998, which included a broader indication of use than currently granted in the United States. Gross margin on Integra LifeSciences product sales decreased $0.3 million from $7.0 million in 1997 (50% of product sales) to $6.7 million in 1998 (47% of product sales). In 1998, gross margin on product sales included $0.3 million of fair value purchase accounting adjustments related to acquired product lines. Excluding these purchase accounting adjustments, gross margin on Integra LifeSciences product sales would have been 49% of product sales in 1998.

Total other revenue increased $2.6 million in 1998 to $3.4 million. Other revenue in the Integra NeuroSciences segment increased $0.9 million from $0.1 million in 1997 to $1.0 million in 1998. In 1998, other revenue consisted of $1.0 million of revenue as partial reimbursement of research and development costs previously expended by the Company. Other revenue in the Integra LifeSciences segment increased from $0.7 million in 1997 to $2.4 million in 1998. In 1998, other revenue consisted of $1.0 million of development funding received from DePuy in connection with the Company's articular cartilage regeneration development program, $0.8 million of grant revenue, $0.3 million of royalty income and $0.3 million of license revenue. In 1997, other revenue in the Integra LifeSciences segment consisted of grant revenue of $0.4 million and $0.3 million of royalty income.

Research and development expenses were as follows (in thousands):

| | 1998 | 1997 |
|---|---|---|
| Integra NeuroSciences | $ 924 | $ 334 |
| Integra LifeSciences | 7,314 | 5,888 |
| Total | $8,238 | $6,222 |

Research and development expense in the Integra NeuroSciences segment increased $0.6 million to $0.9 million in 1998. Integra NeuroSciences research and development activities in 1998 and 1997 consisted of programs involving the DuraGen(TM) Dural Graft Matrix and the peripheral nerve guide.

Research and development activities within the Integra LifeSciences segment increased $1.4 million to $7.3 million in 1998. This increase was primarily related to research funding for the Company's articular cartilage regeneration, with additional increases in the Company's INTEGRA(R) Artificial Skin and orthopedic programs.

Approximately 22% and 8% of the Company's total research and development expenses in 1998 and 1997, respectively, were funded through external grants and development funding programs.

Selling and marketing expenses were as follows (in thousands):

| | 1998 | 1997 |
|---|---|---|
| Integra NeuroSciences | $ 627 | $ -- |
| Integra LifeSciences | 5,326 | 5,458 |
| Total | $5,953 | $5,458 |

Integra NeuroSciences selling and marketing expense increased to $0.6 million in 1998 primarily because of pre-launch activities for the DuraGen(TM) Dural Graft Matrix.

General and administrative expenses were as follows (in thousands):

| | 1998 | 1997 |
|---|---|---|
| Integra NeuroSciences | $ 417 | $ 102 |
| Integra LifeSciences | 1,989 | 1,005 |
| Corporate | 6,951 | 13,323 |
| Total | $ 9,357 | $14,430 |

Integra NeuroSciences general and administrative expense increased $0.3 million to $0.4 million in 1998. General and administrative expense in the Integra LifeSciences segment increased $1.0 million to $2.0 million in 1998 primarily due to acquisition related activities in the Integra LifeSciences segment and additional headcount. The decrease of $6.4 million in corporate general and administrative expenses to $7.0 million in 1998 resulted primarily from the following two non-cash charges recorded in 1997: a $1.0 million asset impairment charge associated with certain leasehold improvements due to the closure of the West Chester facility, and a $5.9 million charge related to a fully restated equity-based signing bonus for the Company's President and Chief Executive Officer. Offsetting these decreases was a $0.2 million asset impairment charge recorded in 1998 and increased costs associated with additional headcount and continued litigation and intellectual property maintenance expenditures incurred in 1998. The Company settled three litigation matters during 1998, but continued to incur significant litigation costs associated with the patent infringement lawsuit against Merck KGaA.

Amortization and other depreciation (excluding $0.8 million and $1.4 million of depreciation included in cost of sales in 1998 and 1997, respectively) were as follows (in thousands):

| | 1998 | 1997 |
|---|---|---|
| Integra NeuroSciences | $ 42 | $ 14 |
| Integra LifeSciences | 288 | 221 |
| Corporate | 337 | 285 |
| Total | $667 | $520 |

Amortization and other depreciation in 1998 and 1997 consisted almost entirely of depreciation.

Interest income decreased $0.5 million to $1.3 million in 1998 because of lower average cash and investment balances during the year and lower interest rates.

Other income increased $0.4 million to $0.6 million in 1998 because of a $0.6 million favorable litigation settlement recorded in 1998.

Liquidity and Capital Resources

The Company has incurred losses from operations since its inception and will continue to incur such losses unless and until product sales and research and collaborative arrangements generate sufficient revenue to fund continuing operations. As of December 31, 1999, the Company had an accumulated deficit of $94.3 million.

The Company has funded its operations to date primarily through private and public offerings of equity securities, product revenues, research and collaboration funding, borrowings under a revolving credit line and cash acquired in connection with business acquisitions and dispositions. At December 31, 1999, the Company had cash, cash equivalents and short-term investments of approximately $23.6 million and $9.9 million in short and long-term bank loans. The Company's principal uses of funds during 1999 were $14.9 million in the acquisition of NeuroCare, $2.3 million in purchases of property and equipment and $1.1 million in repayments of term loans. Net cash flows provided by operations in 1999 were $2.5 million, which reflected $9.9 million received under the JJM Agreement, of which $3.4 million and $5.0 million was recorded in customer advances and deposits and deferred revenue, respectively, at December 31, 1999. During 1999, the Company also received $6.4 million in connection with the sale of a product line, raised $10.0 million from the sale of Series B Preferred Stock and warrants to affiliates of Soros Private Equity Partners LLC and assumed $11.0 million of term debt from Fleet Capital Corporation ("Fleet") in connection with the NeuroCare acquisition. As part of the assumption of the term loan, the Company obtained a $4.0 million revolving credit facility from Fleet, of which a de minimis amount was drawn down at December 31, 1999.

The term loan and the revolving credit facility from Fleet, as amended (collectively, the "Fleet Credit Facility"), are collateralized by all the assets and ownership interests of various subsidiaries of the Company including Integra NeuroCare LLC, and NeuroCare Holding Corporation (the parent company of Integra NeuroCare LLC) has guaranteed Integra NeuroCare LLC's obligations. Integra NeuroCare LLC is subject to various financial and non-financial covenants under the Fleet Credit Facility, including significant restrictions on its ability to transfer funds to the Company or the Company's other subsidiaries. The financial covenants specify minimum levels of interest and fixed charge coverage and net worth, and also specify maximum levels of capital expenditures and total indebtedness to operating cash flow, among others. Effective September 29, 1999 and December 31, 1999, certain of these financial covenants were amended. These amendments did not change any other terms of the Fleet Credit Facility. While the Company anticipates that Integra NeuroCare LLC will be able to satisfy the requirements of these amended financial covenants, there can be no assurance that Integra NeuroCare LLC will generate sufficient earnings before interest, taxes, depreciation and amortization to meet the requirements of such covenants. The term loan is subject to mandatory prepayment amounts if certain levels of cash flow are achieved. The majority of the business acquired in the NeuroCare acquisition is reported in the Integra NeuroSciences segment.

In the short-term, the Company believes that it has sufficient resources to fund its operations. However, in the longer-term, there can be no assurance that the Company will be able to generate sufficient revenues to obtain positive operating cash flows or profitability.

Other Matters

Net Operating Losses

At December 31, 1999, the Company had net operating loss carryforwards ("NOL's") of approximately $50 million and $28 million for federal and state income tax purposes, respectively, to offset future taxable income, if any. The federal and state NOL's expire through 2018 and 2005, respectively.

At December 31, 1999, several of the Company's subsidiaries had unused NOL and tax credit carryforwards arising from periods prior to the Company's ownership. Excluding the Company's Telios Pharmaceuticals, Inc. subsidiary ("Telios"), approximately $9 million of these NOL's for federal income tax purposes expire between 2001 and 2005. The Company's Telios subsidiary has approximately $84 million of net operating losses, which expire between 2002 and 2010. The amount of Telios' net operating loss that is available and the Company's ability to utilize such loss is dependent on the determined value of Telios at the date of acquisition. The Company has a valuation allowance of $42 million against all deferred tax assets, including the net operating losses, due to the uncertainty of realization. The timing and manner in which these acquired net operating losses may be utilized in any year by the Company are severely limited by the Internal Revenue Code of 1986, as amended, Section 382 and other provisions of the Internal Revenue Code and its applicable regulations.

New Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133 "Accounting for Derivative Investments and Hedging Activities" ("SFAS No. 133"). SFAS No. 133 establishes accounting and reporting standards for derivatives and hedging activities and supercedes several existing standards. SFAS No. 133, as amended by SFAS No. 137, is effective for all fiscal quarters of fiscal years beginning after June 15, 2000. The Company does not expect that the adoption of SFAS No. 133 will have a material impact on the consolidated financial statements.

In December 1999 (as amended in March 2000) the staff of the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin 101, Revenue Recognition (the "SAB"). To the extent the guidance in the SAB differs from generally accepted accounting principles previously utilized by an SEC registrant, the SAB indicates that the SEC staff will not object to reporting the cumulative effect of a change in accounting principle.

Prior to promulgation of the SAB, the Company had reported some non-refundable, up-front and milestone fees received pursuant to distribution agreements in the period earned, which was deemed to be the date when all related material commitments had been satisfied and no future consideration was required. While the Company believes the related supply arrangements entered into with its distributors provides for arms-length pricing of product sales, the SAB requires that the distribution agreement fees now be linked to the supply arrangements and reported as additional revenue from product sales made pursuant to those arrangements. As a result, up-front distribution agreement fees are initially deferred and subsequently amortized on a straight-line basis over the contractual period of the supply arrangements.

The Company is currently assessing the full impact that the SAB will have on its financial statements. Once the final assessment is complete, the total financial impact of the SAB will be recorded as a cumulative effect of a change in accounting principle in the first quarter of 2000. The Company currently anticipates that the cumulative effect as of January 1, 2000 of the change in accounting principle (if measured at January 1, 2000) would be approximately $1.3 million. Such amount had previously been reported as other revenue and represents the amount of deferred revenue that would have remained unamortized as of January 1, 2000 with respect to payments previously received and for which the Company expects to record future other revenue under the related supply agreements. The unamortized deferred revenue is determined as if the above noted accounting principle required by the SAB had always been in place.

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risks arising from an increase in interest rates payable on variable rate term loan. For example, based on the remaining term loan outstanding at December 31, 1999, an annual interest rate increase of 100 basis points would increase interest expense by approximately $99,000.

## ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Financial statements and the financial statement schedules specified by this Item, together with the reports thereon of PricewaterhouseCoopers LLP, are presented following Item 14 of this report.

## ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

PART III

INCORPORATED BY REFERENCE

The information called for by Item 10 "Directors and Executive Officers of the Registrant" (other than the information concerning executive officers set forth after Item 4 herein), Item 11 "Executive Compensation", Item 12 "Security Ownership of Certain Beneficial Owners and Management" and Item 13 "Certain Relationships and Related Transactions" is incorporated herein by reference to the Company's definitive proxy statement for its Annual Meeting of Stockholders scheduled to be held on May 16, 2000, which definitive proxy statement is expected to be filed with the Commission not later than 120 days after the end of the fiscal year to which this report relates.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) Documents filed as a part of this report.

1. Financial Statements. The following financial statements and financial statement schedule are filed as a part of this report.


| | |
|---|---|
| Report of Independent Accountants | F-1 |
| Consolidated Balance Sheets as of December 31, 1999 and 1998 | F-2 |
| Consolidated Statements of Operations and Statements of Comprehensive Loss for the years ended December 31, 1999, 1998 and 1997 | F-3 |
| Consolidated Statements of Cash Flows for the years ended December 31, 1999, 1998 and 1997 | F-4 |
| Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 1999, 1998 and 1997 | F-5 |
| Notes to Consolidated Financial Statements | F-6 |
| Report of Independent Accountants on Financial Statement Schedules | F-25 |
| Financial Statement Schedules | F-26 |


All other schedules not listed above have been omitted, because they are not applicable or are not required, or because the required information is included in the consolidated financial statements or notes thereto.

2. Exhibits.

| Number | Description | Location |
|---|---|---|
| 2.1 | Purchase Agreement dated January 5, 1999 among Integra LifeSciences Corporation, Rystan Company, Inc. and Healthpoint, Ltd.** | (11) (Exh. 2) |
| 2.2 | Asset Purchase Agreement dated March 29, 1999 among Heyer-Shulte NeuroCare, L.P., Neuro Navigational, L.L.C., Integra NeuroCare LLC and Redmond NeuroCare LLC.** | (12) (Exh. 2) |
| 3.1(a) | Amended and Restated Certificate of Incorporation of the Company | (2) (Exh. 3.1) |
| 3.1(b) | Certificate of Amendment to Amended and Restated Certificate of Incorporation dated May 23, 1998 | (3)(Exh.3.1(b) |
| 3.2 | Amended and Restated By-laws of the Company | (8) (Exh. 3.3) |
| 4.1 | Certificate of Designation, Preferences and Rights of Series A Convertible Preferred Stock as filed with the Delaware Secretary of State on April 14, 1998. | (6) (Exh. 3) |
| 4.2 | Certificate of Designation, Preferences and Rights of Series B Convertible Preferred Stock as filed with the Delaware Secretary of State on March 12, 1999 | (3) (Exh. 4.2) |
| 4.3 | Warrant to Purchase 60,000 shares of Common Stock of Integra LifeSciences Corporation issued to SFM Domestic Investments LLC. | (12)(Exh. 4.2) |
| 4.4 | Warrant to Purchase 180,000 shares of Common Stock of Integra LifeSciences Corporation issued to Quantum Industrial Partners LDC. | (12)(Exh. 4.3) |
| 10.1 | License Agreement between MIT and the Company dated as of December 29, 1993 | (2) (Exh. 10.1) |
| 10.2 | Exclusive License Agreement between the Company and Rutgers University dated as of December 31, 1994 | (2) (Exh. 10.5) |
| 10.3 | License Agreement for Adhesion Peptides Technology between La Jolla Cancer Research Foundation and Telios dated as of June 24, 1987 | (2) (Exh. 10.6) |
| 10.4 | Supply Agreement between Genetics Institute, Inc. and the Company dated as of April 1, 1994 | (2) (Exh. 10.12) |
| 10.5(a) | Stockholder Rights Agreement between the Company and Union Carbide dated as of April 30, 1993 ("Carbide Agreement") | (2) (Exh. 10.27(a)) |
| 10.5(b) | Amendment dated November 30, 1993 to Carbide Agreement | (2) (Exh. 10.27(b)) |
| 10.6(a) | Real Estate Lease & Usage Agreement between BHP Diagnostics, Inc., Medicus Technologies, Inc., Integra, Ltd. and the Company dated as of May 1, 1994 | (2) (Exh. 10.28) |
| 10.6(b) | Shared Facilities Usage Agreement Between BHP Diagnostics, Inc., Medicus Technologies, Inc., Integra, Ltd. and the Company dated as of May 1, 1994 | (2) (Exh. 10.29) |
| 10.6(c) | Agreement dated June 30, 1998 by and among BHP Diagnostics, Medicus Corporation, Integra Lifesciences I, Ltd. and Integra Lifesciences Corporation | (3) (Exh. 10.18(c)) |
| 10.7 | Lease between Plainsboro Associates and American Biomaterials Corporation dated as of April 16, 1985, as assigned to Colla-Tec, Inc. on October 24, 1989 and as amended through November 1, 1992 | (2) (Exh. 10.30) |
| 10.8 | Form of Indemnification Agreement between the Company and [ ] dated August 16, 1995, including a schedule identifying the individuals that are a party to such Indemnification Agreements | (4) (Exh.10.37) |
| 10.9 | 1992 Stock Option Plan* | (2) (Exh. 10.31) |
| 10.10 | 1993 Incentive Stock Option and Non-Qualified Stock Option Plan* | (2) (Exh. 10.32) |
| 10.11(a) | 1996 Incentive Stock Option and Non-Qualified Stock Option Plan* | (5) (Exh. 4.3) |
| 10.11(b) | Amendment to 1996 Incentive Stock Option and Non-Qualified Stock Option Plan* | (8) (Exh. 10.4) |

| | | |
|---|---|---|
| 10.12 | 1998 Stock Option Plan* | (7) (Exh. 10.2) |
| 10.13 | 1999 Stock Option Plan* | (1) |
| 10.14 | Employee Stock Purchase Plan* | (7) (Exh. 10.1) |
| 10.15 | Deferred Compensation Plan* | (1) |
| 10.16 | Registration Rights Agreement dated as of April 30, 1998 by and between Integra Life Sciences Corporation and Century Medical, Inc. | (6) (Exh. 10.2) |
| 10.17 | Registration Rights Agreement dated September 28, 1998 between the Company and GWC Health, Inc. | (9) (Exh. 10.1) |
| 10.18 | Series B Convertible Preferred Stock and Warrant Purchase Agreement dated March 29, 1999 among Integra LifeSciences Corporation, Quantum Industrial Partners LDC and SFM Domestic Investments LLC | (12)(Exh. 10.1) |
| 10.19 | Registration Rights Agreement dated March 29, 1999 among Integra LifeSciences Corporation, Quantum Industrial Partners LDC and SFM Domestic Investments LLC | (12) (Exh. 10.2) |
| 10.20 | Employment Agreement dated December 27, 1997 between the Company and Stuart M. Essig* | (8) (Exh. 10.1) |
| 10.21 | Stock Option Grant and Agreement dated December 27, 1997 between the Company and Stuart M. Essig* | (8) (Exh. 10.2) |
| 10.22 | Restricted Units Agreement dated December 27, 1997 between the Company and Stuart M. Essig* | (8) (Exh. 10.3) |
| 10.23 | Indemnity letter agreement dated December 27, 1997 from the Company to Stuart M. Essig* | (8) (Exh. 10.5) |
| 10.24 | Employment Agreement between John B. Henneman, III and the Company dated September 11, 1998* | (10) (Exh. 10) |
| 10.25 | Employment Agreement between George W. McKinney, III and the Company dated December 31, 1998* | (3) (Exh. 10.36) |
| 10.26 | Employment Agreement between Judith O'Grady and the Company dated December 31, 1998* | (3) (Exh. 10.37) |
| 10.27 | Employment Agreement between David B. Holtz and the Company dated December 31, 1998* | (3) (Exh. 10.38) |
| 10.28 | Manufacturing and Distribution Agreement dated January 5, 1999 among Integra LifeSciences Corporation, Rystan Company, Inc., Healthpoint, Ltd. and DPT Laboratories, Inc. | (11) (Exh. 10) |
| 10.29(a) | Amended and Restated Loan and Security Agreement dated March 29, 1999 among the Lenders named therein, Fleet Capital Corporation, Integra NeuroCare LLC and other Borrowers named therein. | (12) (Exh. 10.3) |
| 10.29(b) | Amendment No. 1, dated September 29, 1999, to the Amended and Restated Loan and Security Agreement dated March 29, 1999 among the Lenders named therein, Fleet Capital Corporation, Integra NeuroCare LLC and other Borrowers named therein. | (14) (Exh. 10.1) |
| 10.30 | Substituted and Amended Term Note dated March 29, 1999 by Integra NeuroCare LLC, Redmond NeuroCare LLC, Heyer-Schulte NeuroCare, Inc. and Camino NeuroCare, Inc. to Fleet Capital Corporation. | (12) (Exh. 10.4) |
| 10.31 | Supply, Distribution and Collaboration Agreement between Integra LifeSciences Corporation and Johnson & Johnson Medical, a Division of Ethicon, Inc. dated as of June 3, 1999, certain portions of which are subject to a request for confidential treatment under Rule 24b-2 of the Securities Exchange Act of 1934. | (13) (Exh. 10.1) |
| 10.32 | Lease Contract dated June 30, 1994 between | (1) |

| | | |
|---|---|---|
| | the Puerto Rico Industrial Development Company and Heyer-Schulte NeuroCare, Inc. | |
| 10.33 | Industrial Real Estate Triple Net Sublease dated April 1, 1993 between GAP Portfolio Partners and Camino Laboratories. | (1) |
| 10.34 | Industrial Real Estate Triple Net Sublease dated January 15, 1997 between Sorrento Montana, L.P. and Camino NeuroCare, Inc. | (1) |
| 21 | Subsidiaries of the Company | (1) |
| 23 | Consent of PricewaterhouseCoopers LLP | (1) |
| 27 | Financial Data Schedule | (1) |

- ----------

* Indicates a management contract or compensatory plan or arrangement.

** Schedules and other attachments to the indicated exhibit were omitted. The Company agrees to furnish supplementally to the Commission upon request a copy of any omitted schedules or attachments.

(1) Filed herewith.

(2) Incorporated by reference to the indicated exhibit to the Company's Registration Statement on Form 10/A (File No. 0-26224) which became effective on August 8, 1995.

(3) Incorporated by reference to the indicated exhibit to the Company's Annual Report on Form 10-K for the year ended December 31, 1998.

(4) Incorporated by reference to the indicated exhibit to the Company's Registration Statement on Form S-1 (File No. 33-98698) which became effective on January 24, 1996.

(5) Incorporated by reference to the indicated exhibit to the Company's Registration Statement on Form S-8 (File No. 333-06577) which became effective on June 22, 1996.

(6) Incorporated by reference to the indicated exhibit to the Company's Report on Form 10-Q for the quarter ended March 31, 1998.

(7) Incorporated by reference to the indicated exhibit to the Company's Registration Statement on Form S-8 (File No. 333-58235) which became effective on June 30, 1998.

(8) Incorporated by reference to the indicated exhibit to the Company's Report on Form 8-K filed on February 3, 1998.

(9) Incorporated by reference to the indicated exhibit to the Company's Report on Form 8-K filed on October 13, 1998.

(10) Incorporated by reference to the indicated exhibit to the Company's Report on Form 10-Q for the quarter ended September 30, 1998.

(11) Incorporated by reference to the indicated exhibit to the Company's Report on Form 8-K filed on January 20, 1999.

(12) Incorporated by reference to the indicated exhibit to the Company's Report on Form 8-K filed on April 13, 1999.

(13) Incorporated by reference to the indicated exhibit to the Company's Report on Form 10-Q for the quarter ended June 30, 1999.

(14) Incorporated by reference to the indicated exhibit to the Company's Report on Form 10-Q for the quarter ended September 30, 1999.

(b) Reports on Form 8-K
None.

SIGNATURES

Pursuant to the requirements of Section 13 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, as of the 30th day of March, 2000.

INTEGRA LIFESCIENCES HOLDINGS CORPORATION

By: /s/ Stuart M. Essig

Stuart M. Essig, Ph.D.
President

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons, on behalf of the registrant in the capacities indicated, on the 30th day of March, 2000.

| Signature | Title |
|---|---|
| /s/ Stuart M. Essig<br>Stuart M. Essig, Ph.D. | President, Chief Executive Officer and Director (Principal Executive Officer) |
| /s/ George W. McKinney, III<br>George W. McKinney, III, Ph.D. | Executive Vice President, Chief Operating Officer and Director |
| /s/ David B. Holtz<br>David B. Holtz | Vice President, Finance and Treasurer (Principal Financial and Accounting Officer) |
| /s/ Richard E. Caruso<br>Richard E. Caruso, Ph.D. | Chairman of the Board |
| /s/ Keith Bradley<br>Keith Bradley, Ph.D. | Director |
| /s/ Neal Moszkowski<br>Neal Moszkowski | Director |
| /s/ James M. Sullivan<br>James M. Sullivan | Director |

## REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and
Stockholders of Integra LifeSciences
Holdings Corporation and Subsidiaries:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, comprehensive loss, stockholders' equity and cash flows present fairly, in all material respects, the financial position of Integra LifeSciences Holdings Corporation and Subsidiaries (the "Company") at December 31, 1999 and 1998 and the results of operations, comprehensive loss and cash flows for each of the three years in the period ended December 31, 1999, in conformity with accounting principles generally accepted in the United States. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

PRICEWATERHOUSECOOPERS LLP

Florham Park, New Jersey
March 1, 2000, except for Note 20,
as to which the date is March 29, 2000

INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

In thousands

| | December 31, 1999 | December 31, 1998 |
|---|---|---|
| **ASSETS** | | |
| Current Assets: | | |
| Cash and cash equivalents | $ 19,301 | $ 5,277 |
| Short-term investments | 4,311 | 14,910 |
| Accounts receivable, net of allowances of $944 and $354 | 8,365 | 3,106 |
| Inventories | 10,111 | 2,713 |
| Prepaid expenses and other current assets | 718 | 921 |
| Total current assets | 42,806 | 26,927 |
| Property and equipment, net | 9,699 | 6,291 |
| Goodwill and other intangible assets, net | 13,219 | 1,446 |
| Other assets | 529 | 43 |
| Total assets | $ 66,253 | $ 34,707 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Current Liabilities: | | |
| Short-term loans and current maturities of long-term loans | $ 2,254 | $ -- |
| Accounts payable, trade | 994 | 573 |
| Accrued expenses | 5,540 | 2,207 |
| Income taxes payable | 643 | -- |
| Customer advances and deposits | 3,901 | 249 |
| Deferred revenue | 1,460 | -- |
| Total current liabilities | 14,792 | 3,029 |
| Long-term loan | 7,625 | -- |
| Deferred revenue | 5,049 | -- |
| Other liabilities | 798 | 312 |
| Total liabilities | 28,264 | 3,341 |
| Commitments and contingencies | | |
| Stockholders' Equity: | | |
| Preferred stock, $.01 par value (15,000 authorized shares; 500 Series A Convertible shares issued and outstanding at December 31, 1999 and 1998, $4,000 liquidation preference; 100 Series B Convertible shares issued and outstanding at December 31, 1999, $10,000 with a 10% compounded annual cumulative dividend liquidation preference) | 6 | 5 |
| Common stock, $.01 par value (60,000 authorized shares; 16,131 and 15,783 issued and outstanding at December 31, 1999 and 1998, respectively) | 161 | 158 |
| Additional paid-in capital | 132,340 | 119,999 |
| Treasury stock, at cost (1 and 52 shares at December 31, 1999 and 1998, respectively) | (7) | (286) |
| Unearned compensation related to stock options | (108) | (148) |
| Notes receivable - related party | (35) | (35) |
| Accumulated other comprehensive loss | (64) | (40) |
| Accumulated deficit | (94,304) | (88,287) |
| Total stockholders' equity | 37,989 | 31,366 |
| Total liabilities and stockholders' equity | $ 66,253 | $ 34,707 |

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

INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

In thousands, except per share amounts

| | Years Ended December 31, | | |
|---|---|---|---|
| | 1999 | 1998 | 1997 |
| REVENUES | | | |
| Product sales | $ 39,661 | $ 14,076 | $ 14,001 |
| Other revenue | 2,829 | 3,379 | 745 |
| Total revenue | 42,490 | 17,455 | 14,746 |
| COSTS AND EXPENSES | | | |
| Cost of product sales, including depreciation of $1,286, $771 and $1,383 | 22,219 | 7,420 | 7,027 |
| Research and development | 8,670 | 8,238 | 6,222 |
| Selling and marketing | 9,481 | 5,953 | 5,458 |
| General and administrative | 12,682 | 9,357 | 14,430 |
| Amortization and other depreciation | 1,818 | 667 | 520 |
| Total costs and expenses | 54,870 | 31,635 | 33,657 |
| Operating loss | (12,380) | (14,180) | (18,911) |
| Interest income | 1,006 | 1,250 | 1,771 |
| Interest expense | (712) | -- | -- |
| Gain on disposition of product line | 4,161 | -- | -- |
| Other income | 141 | 588 | 176 |
| Net loss before income taxes | (7,784) | (12,342) | (16,964) |
| Income tax benefit | 1,818 | -- | -- |
| Net loss | $ (5,966) | $ (12,342) | $ (16,964) |
| Basic and diluted net loss per share | $ (0.40) | $ (0.77) | $ (1.15) |
| Weighted average common shares outstanding | 16,802 | 16,139 | 14,810 |

INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

In thousands

| | Years Ended December 31, | | |
|---|---|---|---|
| | 1999 | 1998 | 1997 |
| Net loss | $ (5,966) | $ (12,342) | $ (16,964) |
| OTHER COMPREHENSIVE LOSS | | | |
| Unrealized loss on investments | (24) | (14) | (22) |
| Comprehensive loss | $ (5,990) | $ (12,356) | $ (16,986) |

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

INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

| In thousands | Years Ended December 31, | | |
|---|---|---|---|
| | 1999 | 1998 | 1997 |
| **OPERATING ACTIVITIES:** | | | |
| Net loss | $ (5,966) | $ (12,342) | $ (16,964) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | | |
| Depreciation and amortization | 3,104 | 1,438 | 1,903 |
| Gain on sale of product line and other assets | (3,998) | (64) | (162) |
| Provision for impairment of assets | -- | 145 | 1,021 |
| Deferred tax benefit | (1,807) | -- | -- |
| Amortization of discount and interest on investments | (291) | (481) | (126) |
| Amortization of deferred revenue | (610) | -- | -- |
| Compensation associated with the issuance of stock options | 370 | 319 | 123 |
| Restricted units issued | -- | -- | 5,875 |
| Changes in assets and liabilities, net of business acquisitions: | | | |
| Accounts receivable | (510) | (287) | 122 |
| Inventories | 2,829 | 527 | 285 |
| Prepaid expenses and other current assets | 217 | 65 | (62) |
| Non-current assets | (80) | 64 | (81) |
| Accounts payable, accrued expenses and other current liabilities | (677) | 802 | 187 |
| Customer advances and deposits | 3,652 | -- | -- |
| Deferred revenue | 6,269 | -- | -- |
| Net cash provided by (used in) operating activities | 2,502 | (9,814) | (7,879) |
| **INVESTING ACTIVITIES:** | | | |
| Proceeds from sale of product line and other assets | 6,354 | 48 | 183 |
| Proceeds from the sales/maturities of investments | 26,000 | 33,020 | 35,500 |
| Purchases of available for sale investments | (14,737) | (23,274) | (37,071) |
| Purchase of restricted equity securities | -- | (500) | -- |
| Purchases of property and equipment | (2,309) | (1,166) | (770) |
| Cash acquired in a business acquisition | -- | 1,118 | -- |
| Cash used in business acquisition, net of cash acquired | (14,944) | -- | -- |
| Net cash provided by (used in) investing activities | 364 | 9,246 | (2,158) |
| **FINANCING ACTIVITIES:** | | | |
| Net proceeds from revolving credit facility | 4 | -- | -- |
| Repayments of term loan | (1,125) | -- | -- |
| Proceeds from sales of preferred stock | 9,942 | 4,000 | -- |
| Proceeds from exercise of common stock purchase warrants | 1,950 | -- | -- |
| Proceeds from stock issued under employee benefit plans | 467 | 95 | 358 |
| Purchases of treasury stock | -- | (286) | -- |
| Preferred dividends paid | (80) | (47) | -- |
| Net cash provided by financing activities | 11,158 | 3,762 | 358 |
| Net increase (decrease) in cash and cash equivalents | 14,024 | 3,194 | (9,679) |
| Cash and cash equivalents at beginning of period | 5,277 | 2,083 | 11,762 |
| Cash and cash equivalents at end of period | $ 19,301 | $ 5,277 | $ 2,083 |
| Cash paid during the year for interest | $ 654 | $ -- | $ -- |
| Cash paid during the year for income taxes | 124 | -- | -- |
| Supplemental disclosure of non-cash investing and financing activities: | | | |
| Assumption of term loan in connection with the acquisition of the NeuroCare group of companies | $ 11,000 | $ -- | $ -- |
| Common stock and warrants issued in business acquisition | -- | 3,886 | -- |
| Common stock issued in settlement of obligations | 15 | -- | -- |
| Stock purchase warrants issued in settlement of obligations | -- | 56 | -- |
| Issuance of Restricted Units | -- | -- | 5,875 |

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

INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

In thousands

| | Common Stock | | Preferred Stock | | | | |
|---|---|---|---|---|---|---|---|
| | Shares | Amount | Shares | Amount | Treasury Stock | Additional Paid-In Capital | Notes Receivable Related Parties |
| Balance, December 31, 1996 | 14,276 | $ 143 | -- | $ -- | $ -- | $ 105,589 | $ (35) |
| Net loss | -- | -- | -- | -- | -- | -- | -- |
| Other comprehensive loss | -- | -- | -- | -- | -- | -- | -- |
| Issuance of common stock under employee benefit plans | 676 | 7 | -- | -- | -- | 352 | -- |
| Unearned compensation related to non-employee stock options | -- | -- | -- | -- | -- | 61 | -- |
| Amortization of unearned compensation | -- | -- | -- | -- | -- | -- | -- |
| Issuance of restricted units | -- | -- | -- | -- | -- | 5,875 | -- |
| Balance, December 31, 1997 | 14,952 | 150 | -- | -- | -- | 111,877 | (35) |
| Net loss | -- | -- | -- | -- | -- | -- | -- |
| Other comprehensive loss | -- | -- | -- | -- | -- | -- | -- |
| Issuance of Series A Preferred Stock | -- | -- | 500 | 5 | -- | 3,995 | -- |
| Issuance of common stock under employee benefit plans | 31 | -- | -- | -- | -- | 95 | -- |
| Common stock and warrants issued in connection with a business acquisition | 800 | 8 | -- | -- | -- | 3,878 | -- |
| Unearned compensation related to non-employee stock options | -- | -- | -- | -- | -- | 145 | -- |
| Amortization of unearned compensation | -- | -- | -- | -- | -- | -- | -- |
| Warrant issued for services rendered | -- | -- | -- | -- | -- | 56 | -- |
| Dividends paid on Series A Preferred Stock ($0.09 per share) | -- | -- | -- | -- | -- | (47) | -- |
| Purchases of treasury stock | -- | -- | -- | -- | (286) | -- | -- |
| Balance, December 31, 1998 | 15,783 | 158 | 500 | 5 | (286) | 119,999 | (35) |
| Net loss | -- | -- | -- | -- | -- | -- | -- |
| Other comprehensive loss | -- | -- | -- | -- | -- | -- | -- |
| Issuance of Series B Preferred Stock | -- | -- | 100 | 1 | -- | 9,941 | -- |
| Issuance of common stock under employee benefit plans | 48 | -- | -- | -- | 264 | 203 | -- |
| Warrants exercised for common stock | 300 | 3 | -- | -- | -- | 1,947 | -- |
| Issuance of stock in settlement of obligation | -- | -- | -- | -- | 15 | -- | -- |
| Unearned compensation related to non-employee stock options | -- | -- | -- | -- | -- | 241 | -- |
| Amortization of unearned compensation | -- | -- | -- | -- | -- | -- | -- |
| Compensation recorded in connection with stock options granted to employees | -- | -- | -- | -- | -- | 89 | -- |
| Dividends paid on Series A Preferred Stock ($0.16 per share) | -- | -- | -- | -- | -- | (80) | -- |
| Balance, December 31, 1999 | 16,131 | $ 161 | 600 | $ 6 | $ (7) | $132,340 | $ (35) |

In thousands

| | Unearned Compensation Related to Stock Options | Accumulated Comprehensive Loss | Accumulated Deficit | Total Equity |
|---|---|---|---|---|
| Balance, December 31, 1996 | $ (328) | $ (4) | $ (58,981) | $46,384 |
| Net loss | -- | -- | (16,964) | (16,964) |
| Other comprehensive loss | -- | (22) | -- | (22) |
| Issuance of common stock under employee benefit plans | -- | -- | -- | 359 |
| Unearned compensation related to non-employee stock options | (61) | -- | -- | -- |
| Amortization of unearned compensation | 123 | -- | -- | 123 |
| Issuance of restricted units | -- | -- | -- | 5,875 |
| Balance, December 31, 1997 | (266) | (26) | (75,945) | 35,755 |
| Net loss | -- | -- | (12,342) | (12,342) |
| Other comprehensive loss | -- | (14) | -- | (14) |
| Issuance of Series A Preferred Stock | -- | -- | -- | 4,000 |
| Issuance of common stock under employee benefit plans | -- | -- | -- | 95 |
| Common stock and warrants issued in connection with a business acquisition | -- | -- | -- | 3,886 |
| Unearned compensation related to non-employee stock options | (145) | -- | -- | -- |
| Amortization of unearned compensation | 263 | -- | -- | 263 |
| Warrant issued for services rendered | -- | -- | -- | 56 |

| | | | | |
|---|---|---|---|---|
| Dividends paid on Series A Preferred Stock ($0.09 per share) .. | -- | -- | -- | (47) |
| Purchases of treasury stock........... | -- | -- | -- | (286) |
| Balance, December 31, 1998............ | (148) | (40) | (88,287) | 31,366 |
| | ==== | === | ======= | ====== |
| Net loss.............................. | -- | -- | (5,966) | (5,966) |
| Other comprehensive loss.............. | -- | (24) | -- | (24) |
| Issuance of Series B Preferred Stock.. | -- | -- | -- | 9,942 |
| Issuance of common stock under employee benefit plans ............ | -- | -- | (51) | 416 |
| Warrants exercised for common stock... | -- | -- | -- | 1,950 |
| Issuance of stock in settlement of obligation ........................ | -- | -- | -- | 15 |
| Unearned compensation related to non-employee stock options ...... | (241) | -- | -- | -- |
| Amortization of unearned compensation. | 281 | -- | -- | 281 |
| Compensation recorded in connection with stock options granted to employees .......................... | -- | -- | -- | 89 |
| Dividends paid on Series A Preferred Stock ($0.16 per share) .. | -- | -- | -- | (80) |
| Balance, December 31, 1999............ | $ (108) | $ (64) | $ (94,304) | $37,989 |
| | ======== | ====== | ========= | ======= |

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

## 1. BUSINESS

Integra LifeSciences Holdings Corporation (the "Company") develops, manufactures and markets medical devices, implants and biomaterials. The Company's operations consist of (1) Integra NeuroSciences, which is a leading provider of implants, instruments, and monitors used in neurosurgery, neurotrauma, and related critical care and (2) Integra LifeSciences, which develops and manufactures a variety of medical products and devices, including products based on our proprietary tissue regeneration technology which are used to treat soft tissue and orthopedic conditions. Integra NeuroSciences sells primarily through a direct sales organization and Integra LifeSciences sells primarily through strategic alliances and distributors.

There are certain risks and uncertainties inherent in the Company's business. To date, the Company has experienced significant operating losses in funding the research, development, manufacturing and marketing of its products and may continue to incur operating losses. The Company's ability to achieve profitability depends in part upon its ability, either independently or in collaboration with others, to successfully manufacture and market its products and services. The industry and market segments in which the Company operates are highly competitive, and the Company may not be able to compete effectively with other companies with greater financial resources. In general, the medical technology industry is characterized by intense competition, which comes from established pharmaceutical and medical technology companies and early stage companies that have alternative technological solutions for the Company's primary clinical targets, as well as universities, research institutions and other non-profit entities. The Company's competitive position and profitability will depend on its ability to achieve market acceptance for its products, implement production and marketing plans, secure regulatory approval for products under development, obtain patent protection and secure adequate capital resources.

The Company believes that current cash balances and funds available from existing revenue sources will be sufficient to finance the Company's anticipated operations for at least the next twelve months. The Company may in the future seek to issue equity securities or enter into other financing arrangements with strategic partners to raise funds in excess of its anticipated liquidity and capital requirements.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly owned. All intercompany accounts and transactions are eliminated in consolidation.

### Reclassifications

Certain prior year amounts have been reclassified to conform with the current year presentation.

### Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with original maturities of three months or less and have virtually no risk of loss in value to be cash equivalents.

### Investments

The Company's current investment policy is to invest available cash balances in high quality debt securities with maturities not to exceed 18 months. Realized gains and losses are determined on the specific identification cost basis. All investments are classified as available for sale, with unrealized gains and losses reported in other comprehensive loss.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

Inventories

Inventories, consisting of purchased materials, direct labor and manufacturing overhead, are stated at the lower of cost, determined on the first-in, first-out method, or market.

Property and Equipment

Property and equipment is stated at cost. The Company provides for depreciation using the straight-line method over the estimated useful lives of the assets, which are estimated to be between 3 and 15 years. Leasehold improvements are amortized using the straight-line method over the minimum lease term or the life of the asset whichever is shorter. The cost of major additions and improvements is capitalized. Maintenance and repair costs that do not improve or extend the lives of the respective assets are charged to operations as incurred. When depreciable assets are retired or sold, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in operations.

Goodwill and Other Intangible Assets

Goodwill other intangible assets were recorded in connection with the acquisition of the NeuroCare Group of companies in March 1999 and the Rystan Company, Inc. in September 1998. Goodwill and other intangibles are being amortized using a straight-line basis over periods ranging from two to fifteen years.

Long-Lived Assets

Long-lived assets held and used by the Company, including goodwill and other intangibles, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. For purposes of evaluating the recoverability of long-lived assets to be held and used, a recoverability test is performed using projected undiscounted net cash flows applicable to the long-lived assets. If an impairment exists, the amount of such impairment is calculated based on the estimated fair value of the asset. Impairments to long-lived assets to be disposed of are recorded based upon the fair value of the applicable assets.

Income Taxes

Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases.

Research and Development

Research and development costs are expensed in the period in which they are incurred.

Revenue Recognition

Product sales are recognized when delivery has occurred or title has passed to the customer, there is a fixed or determinable sales price, and collectibility of that sales price is reasonably assured. Research grant revenue and contract product development revenue are recognized when the related expenses are incurred. Under the terms of existing research grants, the Company is reimbursed for allowable direct and indirect research expenses. Product licensing revenue is recognized ratably over the contract period. Royalty revenue is recognized over the period the royalty products are sold.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

Concentration of Credit Risk

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist principally of cash and cash equivalents and short-term investments, which are held at major financial institutions, and trade receivables. The Company's products are sold on an uncollateralized basis and on credit terms based upon a credit risk assessment of each customer.

Net Loss per Share

Amounts used in the calculation of basic and diluted net loss per share were as follows (in thousands, except per share data):

| | 1999 | 1998 | 1997 |
|---|---|---|---|
| Net loss | $ (5,966) | $(12,342) | $(16,964) |
| Preferred stock dividends | | | |
| Series A Convertible Preferred Stock | (80) | (47) | -- |
| Series B Convertible Preferred Stock | (751) | -- | -- |
| Net loss applicable to common stock | $ (6,797) | $(12,389) | $(16,964) |
| Weighted average common shares outstanding | 16,802 | 16,139 | 14,810 |
| Basic and diluted net loss per share | $ (0.40) | $ (0.77) | $ (1.15) |

Basic loss per share is computed by dividing net loss applicable to common stock by the weighted average number of common shares outstanding for the period. Diluted per share amounts reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock. Options and warrants to purchase 4,401,000, 3,095,000 and 3,778,000 shares of common stock and preferred stock convertible into 2,868,000, 500,000 and 0 shares of common stock at December 31, 1999, 1998 and 1997, respectively were not included in the computation of diluted loss per share because their effect would be antidilutive. The Restricted Units issued by the Company (see Note 11) are included in the weighted average calculation because no further consideration is due related to the issuance of the underlying common shares.

Stock Based Compensation

Employee stock based compensation is recognized using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employees". For disclosures purposes, pro forma net loss and loss per share are presented as if the fair value method had been applied.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, including disclosures of contingent assets and liabilities, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

New Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133 "Accounting for Derivative Investments and Hedging Activities", ("SFAS No. 133"). SFAS No. 133 establishes accounting and reporting standards for derivatives and hedging activities and supercedes several existing standards. SFAS No. 133, as amended by SFAS No. 137, is effective for all fiscal quarters of fiscal years beginning after June 15, 2000. The Company does not expect that the adoption of SFAS No. 133 will have a material impact on the consolidated financial statements.

In December-1999 (as amended in March 2000) the staff of the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin 101, Revenue Recognition (the "SAB"). To the extent the guidance in the SAB differs from generally accepted accounting principles previously utilized by an SEC registrant, the SAB indicates that the SEC staff will not object to reporting the cumulative effect of a change in accounting principle.

Prior to promulgation of the SAB, the Company had reported some non-refundable up-front and milestone fees received pursuant to distribution agreements in the period earned, which was deemed to be the date when all related material commitments had been satisfied and no future consideration was required. While the Company believes the pricing under related supply arrangements entered into with its distributors provides for arms-length pricing of product sales, the SAB requires that the distribution agreement fees now be linked to the supply arrangements and reported as additional revenue from product sales made pursuant to those arrangements. As a result, up-front distribution agreement fees are initially deferred and subsequently amortized on a straight-line basis over the contractual period of the supply arrangements.

The Company is currently assessing the full impact that the SAB will have on its financial statements. Once the final assessment is complete, the total financial impact of the SAB will be recorded as a cumulative effect of a change in accounting principle in the first quarter of 2000. The Company currently anticipates that the cumulative effect as of January 1, 2000 of the change in accounting principle (if measured at January 1, 2000) would be approximately $1.3 million. Such amount had previously been reported as other revenue and represents the amount of deferred revenue that would have remained unamortized as of January 1, 2000 with respect to payments previously received and for which the Company expects to record future other revenue under the related supply agreements. The unamortized deferred revenue is determined as if the above noted accounting principle required by the SAB had always been in place.

3. BUSINESS ACQUISITIONS AND DISPOSITIONS

On March 29, 1999 the Company acquired the business, including certain assets and liabilities, of the NeuroCare group of companies ("NeuroCare"), a leading provider of neurosurgical products. The $25.4 million acquisition price was comprised of $14.4 million of cash and $11.0 million of assumed indebtedness under a term loan from Fleet Capital Corporation ("Fleet"). The cash portion of the purchase price was financed in part by affiliates of Soros Private Equity Partners LLC, through the sale of $10.0 million of Series B Convertible Preferred Stock and warrants. The convertible preferred shares are convertible into 2,617,801 shares of the Company's common stock, have a liquidation preference of $10.0 million with a 10% compounded cumulative annual return, which is payable only upon the Company's conditional redemption of the preferred shares or in the event of a liquidation or change in control, and are senior to all other equity securities of the Company. The warrants issued are for the right to acquire 240,000 shares of the Company's common stock at an exercise price of $3.82 per share.

3. BUSINESS ACQUISITIONS AND DISPOSITIONS, continued

The acquisition has been accounted for under the purchase method of accounting and the results of the acquisition are included in the consolidated financial statements since the acquisition date. The purchase price has been preliminarily allocated based on estimated fair values at the date of acquisition. This preliminary allocation has resulted in acquired intangibles and goodwill of approximately $13.7 million, which is being amortized on a straight-line basis over periods ranging from 2 to 15 years. The following is a summary of the preliminary allocation (in thousands):

| | |
|---|---|
| Cash | $ 285 |
| Accounts receivable | 4,899 |
| Inventory | 10,553 |
| Property and equipment | 3,601 |
| Other assets | 582 |
| Intangibles and goodwill | 13,701 |
| Accrued expenses and other liabilities | (8,218) |
| Term loan | (11,000) |
| | $ 14,403 |

We do not expect the preliminary allocation to change significantly.

On September 28, 1998, the Company acquired Rystan Company, Inc. ("Rystan") for 800,000 shares of common stock of the Company and two warrants each having the right to purchase 150,000 shares of the Company's common stock. The total purchase price was valued at $4.0 million, which exceeded the Company's assessment of the fair value of net assets acquired by approximately $1.5 million. This excess of purchase price over the fair value of net assets acquired was recorded as goodwill and is being amortized on a straight-line basis over 15 years. The acquisition was accounted for using the purchase method of accounting and the results of the acquisition are included in the consolidated financial statements since the acquisition date. In January 1999, the Company subsequently sold a Rystan product line, including the brand name and related production equipment, to Healthpoint, Ltd. for $6.4 million in cash and recognized a pre-tax gain of $4.2 million after adjusting for the net cost of the assets sold and for expenses associated with the divestiture, including the closing of the Rystan facility.

The following unaudited pro forma financial information assumes that these acquisitions had occurred as of the beginning of each period (in thousands):

| | (Unaudited) Year ended December 31, | | |
|---|---|---|---|
| | 1999 | 1998 | 1997 |
| Total revenue | $ 50,412 | $ 53,161 | $ 51,122 |
| Net loss | $ (8,666) | $ (9,964) | $(15,531) |
| Basic and diluted loss per share | $ (0.58) | $ (0.66) | $ (1.06) |

Excluded from the pro forma results for the year ended December 31, 1999 is the $3.7 million gain, net of tax, ($0.22 per share) from the sale of a Rystan product line. Included in the historical and pro forma amounts for the year ended December 31, 1999 are inventory fair value purchase accounting adjustments of $2.2 million, severance costs of $1.1 million and $1.8 million of deferred tax benefits relating to the NeuroCare acquisition. The pro forma amounts for the years ended December 31, 1998 and 1997 include $2.2 million of fair value inventory purchase accounting adjustments and $1.8 million of deferred tax benefits related to the NeuroCare acquisition and $0.3 million of fair value purchase accounting inventory adjustments related to the Rystan acquisition, respectively. These pro forma amounts are based upon certain assumptions and estimates. The pro forma results do not necessarily represent results that would have occurred if the acquisition had taken place on the basis assumed above, nor are they indicative of the results of future combined operations.

## 4. STRATEGIC ALLIANCE

On June 3, 1999, the Company and Johnson & Johnson Medical, Division of Ethicon, Inc. ("JJM"), signed an agreement (the "JJM Agreement") providing JJM with exclusive marketing and distribution rights to INTEGRA(R) Artificial Skin worldwide, excluding Japan.Under the JJM Agreement, the Company will continue to manufacture INTEGRA(R) Artificial Skin and will collaborate with JJM to conduct research and development and clinical research aimed at expanding indications and developing future products in the field of skin repair and regeneration.

Upon signing the JJM Agreement, the Company received a payment from JJM of $5.3 million for the exclusive use of the Company's trademarks and regulatory filings related to INTEGRA(R) Artificial Skin and certain other rights. This amount has been recorded as deferred revenue and is being amortized over the ten-year term of the JJM Agreement. The unamortized balance of $5.0 million at December 31, 1999 is recorded in deferred revenue, of which $0.5 million is classified as short-term. Additionally, the JJM Agreement requires JJM to make non-refundable payments to the Company each year based upon minimum purchases of INTEGRA(R) Artificial Skin. As a result, the Company received a $1.2 million prepayment upon signing the JJM Agreement for minimum purchases in 1999 and a $3.4 million payment in December 1999 for minimum purchases in 2000. The entire $1.2 million initial payment was recorded as product sales in 1999, as JJM's sales to end customers satisfied its 1999 minimum purchase commitment, and the $3.4 million payment is recorded in current liabilities as customer advances and deposits at December 31, 1999.

The JJM Agreement also provides for annual research funding of $2.0 million for the years 2000 through 2004, after which such funding amounts will be determined based upon net sales of INTEGRA(R) Artifical Skin. Additional funding will be received upon the occurrence of certain clinical and regulatory events and for funding expansion of the Company's INTEGRA(R) Artificial Skin production capacity as certain sales targets are achieved.

## 5. INVESTMENTS

The Company's current investment balances are classified as available for sale and all debt securities have maturities within one year. Investment balances as of December 31, 1999 and 1998 were as follows:

| In thousands | Cost | Unrealized Gains | Unrealized Losses | Fair Value |
|---|---|---|---|---|
| 1999: | | | | |
| U.S. Government agency securities | $ 3,975 | $ -- | $ -- | $ 3,975 |
| Equity securities ............... | 400 | -- | (64) | 336 |
| Total ........................ | $ 4,375 | $ -- | $ (64) | $ 4,311 |
| 1998: | | | | |
| U.S. Government agency securities | $14,950 | $ 4 | $ (44) | $14,910 |

6. INVENTORIES

Inventories consist of the following (in thousands):

| | December 31, 1999 | December 31, 1998 |
|---|---|---|
| Finished goods | $ 3,786 | $ 1,433 |
| Work-in-process | 2,224 | 802 |
| Raw materials | 4,101 | 478 |
| | $ 10,111 | $ 2,713 |

7. PROPERTY AND EQUIPMENT

Property and equipment, net, consists of the following (in thousands):

| | December 31, 1999 | December 31, 1998 |
|---|---|---|
| Machinery and equipment | $ 8,923 | $ 4,952 |
| Furniture and fixtures | 559 | 319 |
| Leasehold improvements | 7,805 | 6,840 |
| Construction in progress | 390 | 24 |
| | 17,677 | 12,135 |
| Less: Accumulated depreciation and amortization | (7,978) | (5,844) |
| | $ 9,699 | $ 6,291 |

Depreciation and amortization expense associated with property and equipment for the years ended December 31, 1999, 1998 and 1997 was $2,229,000, $1,413,000 and $1,903,000, respectively.

8. GOODWILL AND OTHER INTANGIBLES

Goodwill and other intangibles, net, consists primarily of identifiable intangible assets and residual goodwill related to the NeuroCare acquisition. The following is a summary of goodwill and other intangible balances (in thousands):

| | December 31, 1999 | December 31, 1998 |
|---|---|---|
| Technology | $ 3,730 | -- |
| Customer base | 1,810 | -- |
| Trademarks | 1,570 | -- |
| Other identifiable intangible assets | 2,661 | -- |
| Goodwill | 4,348 | 1,495 |
| | 14,119 | 1,495 |
| Less: Accumulated amortization | (900) | (49) |
| | $ 13,219 | $ 1,446 |

The assets sold in the disposition of the Rystan product line in January 1999 included approximately $1,031,000 of goodwill related to the product line. Amortization expense associated with goodwill and other intangibles for the years ended December 31, 1999, 1998 and 1997 was $875,000, $49,000 and $0, respectively.

9. CURRENT LIABILITIES

Accrued expenses consist of the following (in thousands):

| | December 31, 1999 | December 31, 1998 |
|---|---|---|
| Acquisition related costs | $ 658 | $ -- |
| Vacation | 533 | 260 |
| Legal fees | 526 | 591 |
| Contract research | 378 | 401 |
| Other | 3,445 | 955 |
| | $ 5,540 | $ 2,207 |

10. DEBT

The NeuroCare acquisition was partially funded through an $11.0 million term loan provided by Fleet. Fleet has also provided a $4.0 million revolving credit facility to fund working capital requirements, of which $4,000 was drawn down as of December 31, 1999. The term loan and revolving credit facility (collectively, the "Fleet Credit Facility") generally bear interest at a variable rate that is based upon the prime lending rate charged for commercial loans in the United States. At December 31, 1999, the weighted average and year-end interest rate on the Company's debt was 9.5%. An option is available to the Company to borrow certain portions of the Fleet Credit Facility at variable rates based upon the London Interbank Overnight Rate ("LIBOR"), subject to certain limitations and restrictions.

The Fleet Credit Facility is collateralized by all the assets and ownership interests of various subsidiaries of the company including Integra NeuroCare LLC and NeuroCare Holding Corporation (the parent company of Integra NeuroCare LLC) has guaranteed Integra NeuroCare LLC's obligations. Integra NeuroCare LLC is subject to various financial and non-financial covenants under the Fleet Credit Facility, including significant restrictions on its ability to transfer funds to the Company or the Company's other subsidiaries. At December 31, 1999, approximately $15.6 million of Integra NeuroCare LLC's net assets were restricted under the provisions of the Fleet Credit Facility. The financial covenants specify minimum levels of interest and fixed charge coverage and net worth, and also specify maximum levels of capital expenditures and total indebtedness to operating cash flow, among others. Effective September 29, 1999 and December 31, 1999, certain of these financial covenants were amended. These amendments did not change any other terms of the Fleet Credit Facility. While the Company anticipates that Integra NeuroCare LLC will be able to satisfy the requirements of these amended financial covenants, there can be no assurance that Integra NeuroCare LLC will generate sufficient earnings before interest, taxes, depreciation and amortization to meet the requirements of such covenants. The majority of the business acquired in the NeuroCare acquisition is reported in the Integra NeuroSciences segment.

10. DEBT, continued

At December 31, 1999, $9,875,000 remained outstanding on the term loan, of which $2,250,000 is classified as short-term. The term loan is repayable as follows: $2,250,000 in 2000, $2,500,000 in 2001, $3,250,000 in 2002 and $1,875,000 in 2003. Notwithstanding these payments, the term loan is subject to mandatory prepayment amounts if certain levels of cash flow are achieved.

## 11. STOCKHOLDERS' EQUITY

### Preferred Stock Transactions

In connection with the NeuroCare acquisition, the Company sold $10.0 million of Series B Preferred Stock to affiliates of Soros Private Equity Partners LLC (see Note 3).

During the second quarter of 1998, the Company sold 500,000 shares of Series A Preferred Stock ("Series A Preferred") for $4.0 million to Century Medical, Inc. ("CMI"). The Preferred Stock pays an annual dividend of $0.16 per share, payable quarterly, and has a liquidation preference of $4.0 million. Each share of Preferred Stock is convertible at any time into one-half share of Company common stock and is redeemable at the option of the Company after December 31, 2007.

### Common Stock Transactions

In September 1998, the Company issued 800,000 shares of Company common stock and two warrants each having the right to purchase 150,000 shares of the Company's common stock to GWC Health, Inc., a subsidiary of Elan Corporation, plc., as consideration for the acquisition of Rystan (See "Common Stock Warrants" below and Note 3).

### Stock Split

The Company's shareholders approved a one-for-two reverse split of the Company's common stock at the annual shareholders meeting held on May 18, 1998. All outstanding common share and per share amounts have been retroactively adjusted to reflect the reverse split.

### Restricted Units

In December 1997, the Company issued one million restricted units ("Restricted Units") as a fully vested equity based signing bonus to the Company's new President and Chief Executive Officer ("Executive"). Each Restricted Unit represents the right to receive one share of the Company's common stock. In connection with the Restricted Units, the Company incurred a non-cash compensation charge of $5.9 million in the fourth quarter of 1997, which is included in general and administrative expenses.

### Common Stock Warrants

In connection with the NeuroCare acquisition, the Company issued two warrants to affiliates of Soros Private Equity Partners LLC having the right to purchase an aggregate of 240,000 shares of the Company's common stock at $3.82 per share. These warrants expire on March 28, 2001.

In connection with the acquisition of Rystan, the Company issued two warrants, each having the right to purchase 150,000 shares of the Company's common stock at $6.00 and $7.00, respectively. Both of these warrants were exercised in October 1999.

In conjunction with a 1993 private placement of 347,947 shares of the Company's common stock to Boston Scientific Corporation the Company sold for additional consideration and issued to BSC a warrant (the "BSC Warrant") to purchase 347,947 shares of the Company's common stock at an exercise price of $14.37 per share. The BSC Warrant expired on January 31, 2000.

11. STOCKHOLDERS' EQUITY , continued

Stockholders' Rights

As stockholders of the Company, Union Carbide Corporation, CMI and GWC Health are entitled to certain registration rights. The Executive also has demand registration rights under the Restricted Units agreement.

12. STOCK OPTIONS

As of December 31, 1999, the Company had stock options outstanding under five stock option plans, the 1992 Stock Option Plan (the "1992 Plan"), the 1993 Incentive Stock Option and Non-Qualified Stock Option Plan (the "1993 Plan"), the 1996 Incentive Stock Option and Non-Qualified Stock Option Plan (the "1996 Plan"), the 1998 Stock Option Plan (the "1998 Plan") and the 1999 Stock Option Plan (the "1999 Plan"). As of June 30, 1997, no additional options can be granted out of the 1992 Plan and 175,000 shares reserved under the 1992 Plan were cancelled.

The Company has reserved 750,000 shares of common stock for issuance under each of the 1993 and 1996 Plans, 1,000,000 shares under the 1998 Plan, and 2,000,000 shares under the 1999 Plan. The 1993 Plan, 1996 Plan, 1998 Plan and the 1999 Plan (together, "the Plans") permit the Company to grant both incentive and non-qualified stock options to designated directors, officers, employees and associates of the Company. Options issued under the Plans become exercisable over specified periods, generally within four years from the date of grant, and generally expire six years from the grant date.

In May 1997, the Company's Stock Option Committee and Board of Directors approved an option exchange program pursuant to which employees with options having an exercise price in excess of $8.00 per share under the Company's Stock Option Plans could elect to exchange such options for new stock options with an exercise price of $8.00. Under the exchange program, (i) the number of replacement options issued in exchange for the original options was determined by the utilization of a formula based on the percentage decrease in exercise price from the original grant (not to exceed 25% of the original options and excluding the first 500 options), (ii) the replacement options expiration dates were adjusted to one year later than the original options expiration dates, and (iii) the vesting terms of the replacement options were adjusted to proportionately reflect the decrease in options, when applicable. Under the exchange program, 542,242 options with exercise prices ranging from $8.50 to $25.00 were exchanged for 445,811 options granted with an exercise price of $8.00, which was in excess of the closing market price at the date of exchange.

The Company has adopted the disclosure-only provisions of SFAS No. 123 "Accounting for Stock Based Compensation" ("SFAS 123") and accordingly no compensation cost has been recognized for the fair value of stock option grants except the amortization of unearned compensation related to options granted to non-employees which amounted to $281,000, $263,000 and $123,000 for the years ended December 31, 1999, 1998 and 1997, respectively. Had the compensation cost for the Company's stock option plans been determined based on the fair value at the grant date for awards in grant since 1995 consistent with the provisions of SFAS No. 123, the Company's net loss and basic and diluted net loss per share would have increased to the pro forma amounts indicated below:

| (In thousands) | 1999 | 1998 | 1997 |
|---|---|---|---|
| Net loss applicable to common stock.................. | $ (6,797) | $ (12,389) | $ (16,964) |
| Pro forma net loss applicable to common stock......... | (9,991) | (15,070) | (17,777) |
| Basic and diluted net loss per share.................. | $ (0.40) | $ (0.77) | $ (1.15) |
| Pro forma basic and diluted net loss per share........ | (0.59) | (0.93) | (1.20) |

12. STOCK OPTIONS, continued

As options vest over a varying number of years and awards are generally made each year, the pro forma impacts shown here may not be representative of future pro forma expense amounts. The pro forma additional compensation expense was calculated based on the fair value of each option grant using the Black-Scholes model with the following weighted-average assumptions:

| | 1999 | 1998 | 1997 |
|---|---|---|---|
| Dividend yield | -0- | -0- | -0- |
| Expected volatility | 90% | 80% | 80% |
| Risk free interest rate | 5.4% | 5.2% | 6.2% |
| Expected option lives | 4 years | 4 years | 6 years |

For the three years ended December 31, 1999, option activity for all the Plans (including the 1992 Plan) was as follows:

| (Shares in thousands) | Weighted-Average Exercise Price | Shares |
|---|---|---|
| December 31, 1996, Outstanding | $ 8.68 | 1,405 |
| December 31, 1996, Exercisable | $ 5.64 | 950 |
| Granted | $ 7.10 | 1,493 |
| Exercised | $ 0.53 | (676) |
| Canceled | $ 15.52 | (681) |
| December 31, 1997, Outstanding | $ 7.68 | 1,541 |
| December 31, 1997, Exercisable | $ 9.36 | 393 |
| Granted | $ 4.35 | 1,045 |
| Exercised | $ 8.00 | (1) |
| Canceled | $ 8.21 | (138) |
| December 31, 1998, Outstanding | $ 6.26 | 2,447 |
| December 31, 1998, Exercisable | $ 8.45 | 730 |
| Granted | $ 5.10 | 1,757 |
| Exercised | $ 4.24 | (61) |
| Canceled | $ 5.56 | (352) |
| December 31, 1999, Outstanding | $ 5.82 | 3,791 |
| December 31, 1999, Exercisable | $ 6.76 | 1,422 |
| December 31, 1999, Available for Grant | | 772 |

12. STOCK OPTIONS, continued

In June 1999, the Company granted fully vested non-qualified stock options with an intrinsic value of $90,000 on the grant date to certain employees for which a corresponding charge was recorded to general and administrative expense. Otherwise, the exercise price of all other stock options granted under the 1992 Plan and the Plans was equal to or greater than the fair market value of the common stock on dates of grant. The weighted average exercise price and fair market value of options granted in 1999, 1998 and 1997 were as follows:

| | Less Than Market Price | | Equal to Market Price | | In Excess of Market Price | |
|---|---|---|---|---|---|---|
| | Exercise Price | Fair Value | Exercise Price | Fair Value | Exercise Price | Fair Value |
| 1999 | $ 3.46 | $ 3.46 | $ 5.11 | $ 3.77 | $ 7.61 | $ 0.06 |
| 1998 | -- | -- | $ 4.19 | $ 2.59 | $ 8.00 | $ 1.98 |
| 1997 | -- | -- | $ 6.44 | $ 4.96 | $ 8.08 | $ 4.56 |

The following table summarizes information about the outstanding and exercisable stock options at December 31, 1999:

| Options in thousands | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| Range of Exercise Prices | As of 12/31/99 | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price | As of 12/31/99 | Weighted Average Exercise Price |
| $3.375 - $5.500 | 1,467 | 4.7 years | $ 3.78 | 433 | $ 3.83 |
| $5.75 - $8.00 | 2,126 | 4.1 years | $ 6.56 | 895 | $ 7.13 |
| $8.125 - $23.00 | 198 | 3.2 years | $ 12.94 | 94 | $ 16.72 |
| | 3,791 | | | 1,422 | |

13. FINANCIAL INSTRUMENTS

Fair value of the Company's financial instruments are estimated as follows (in thousands):

| | December 31, 1999 | | December 31, 1998 | |
|---|---|---|---|---|
| | Fair Value | Carrying Amount | Fair Value | Carrying Amount |
| Nonderivatives | | | | |
| Cash and cash equivalents | $19,301 | $19,301 | $ 5,277 | $ 5,277 |
| Short-term investments | 4,311 | 4,311 | 14,910 | 14,910 |
| Term loans and revolving credit facility | 9,879 | 9,879 | -- | -- |

Fair values were estimated based on market prices, where available. The interest rate on the Company's term loan and borrowings under its revolving credit facility are reset periodically to reflect current market rates.

## 14. LEASES

The Company leases all of its facilities through noncancelable operating lease agreements. In November 1992, a corporation whose shareholders are trusts whose beneficiaries include beneficiaries of a significant shareholder acquired from independent third parties a 50% interest in the general partnership from which the Company leases its manufacturing, research and principal warehouse facility in Plainsboro, New Jersey. The lease provides for rent escalations of 10.1% and 8.5% in the years 2002 and 2007, respectively, and expires in October 2012. The total amount of the minimum lease payments related to the New Jersey facility is being charged to expense on a straight-line basis over the term of the lease.

The Company also leases manufacturing, administrative and laboratory space in San Diego, California, Anasco, Puerto Rico and Irvington, New Jersey under various leases agreements expiring through 2004 that are accounted for as operating leases. The lease agreement related to the Company's research facility in San Diego provides for annual escalations, for which the minimum lease payments are being charged to expense on a straight-line basis over the term of the lease. The Company also leases facilities additional space for administrative support activities and storage under short-term agreements in New Jersey and California.

In May 1994, the Company entered into a 5 year lease agreement with a related party of a significant shareholder for a facility in West Chester, Pennsylvania. In January 1998, the Company decided to suspend its operations at this facility and in June 1998, entered into a lease termination agreement related to the facility that required the Company to pay $330,000 for the facility's maintenance, certain operating costs and other commitments through April 1999. Additionally, the Company recorded asset impairment charges of $1,021,000 in 1997 and $145,000 in 1998, respectively, related to certain leasehold improvements made at the West Chester facility. These charges were expensed in general and administrative expense.

Future minimum lease payments under operating leases at December 31, 1999 were as follows:

In thousands

| | Related Parties | Third Parties | Total |
|---|---|---|---|
| 2000 | $210 | $1,051 | $1,261 |
| 2001 | 210 | 807 | 1,017 |
| 2002 | 213 | 600 | 813 |
| 2003 | 231 | 534 | 765 |
| 2004 | 231 | 458 | 689 |
| Thereafter | 1,909 | -- | 1,909 |
| Total minimum lease payments | $3,004 | $3,450 | $6,454 |

Total rental expense for the years ended December 31, 1999, 1998 and 1997 was $958,000, $780,000 and $640,000, respectively, and included $219,000, $267,000 and $390,000 in related party expense, respectively.

15. INCOME TAXES

The income tax benefit (provision) consisted of the following (in thousands):

| | 1999 | 1998 | 1997 |
|---|---|---|---|
| Current: | | | |
| Federal | $ (100) | $ -- | $ -- |
| State | 113 | -- | -- |
| Total current | 13 | -- | -- |
| Deferred: | | | |
| Federal | 1,671 | -- | -- |
| State | 136 | -- | -- |
| Total deferred | 1,807 | -- | -- |
| Income tax benefit | $ 1,818 | $ -- | $ -- |

The temporary differences which give rise to deferred tax assets and (liabilities) are presented below:

| In thousands | December 31, 1999 | December 31, 1998 |
|---|---|---|
| Net operating loss and tax credit carryforwards | $ 36,800 | $ 36,679 |
| Inventory reserves and capitalization | 1,021 | 1,312 |
| Other | 2,615 | 3,086 |
| Depreciation and amortization | -- | 767 |
| Deferred revenue | 2,560 | -- |
| Total deferred tax assets before valuation allowance | 42,995 | 41,844 |
| Valuation allowance | (41,465) | (41,844) |
| Depreciation and amortization | (1,562) | -- |
| Other | (392) | -- |
| Net deferred tax liabilities | $ (392) | $ -- |

The Company's valuation allowance was provided against the deferred tax assets due to the uncertainty of realization. The net change in the Company's valuation allowance was $18,000, $4,380,000 and $8,511,000 in 1999, 1998 and 1997, respectively. The net deferred tax liability of $392,000 at December 31, 1999 is recorded in Other liabilities.

A reconciliation of the United States Federal statutory rate to the Company's effective tax rate for the years ended December 31, 1999, 1998 and 1997 is as follows:

| | 1999 | 1998 | 1997 |
|---|---|---|---|
| Federal statutory rate | (34.0%) | (34.0%) | (34.0%) |
| Increase (reduction) in income taxes resulting from: | | | |
| State income taxes | 6.9% | -- | -- |
| Benefit from sale of state net operating loss, net of federal effect | (5.5%) | -- | -- |
| Alternative minimum tax, net of state benefit | 1.3% | -- | -- |
| Amortization of goodwill | 0.8% | -- | -- |
| Other nondeductible items | 7.4% | 1.8% | 1.4% |
| Change in valuation allowance | (0.2%) | 32.2% | 32.6% |
| Effective tax rate | (23.3%) | -- | -- |

15. INCOME TAXES, continued

The 1999 change in valuation allowance includes a non-cash benefit of $1.8 million resulting from the deferred tax liabilities recorded in the NeuroCare acquisition to the extent that consolidated deferred tax assets were generated subsequent to the acquisition.

At December 31, 1999, the Company had net operating loss carryforwards ("NOL's") of approximately $50 million and $28 million for federal and state income tax purposes, respectively, to offset future taxable income, if any. The federal and state NOL's expire through 2018 and 2005, respectively. During 1999, the Company recognized a tax benefit of $645,000 for the sale of certain state net operating loss carryforwards through a special program offered by the State of New Jersey.

At December 31, 1999, several of the Company's subsidiaries had unused NOL and tax credit carryforwards arising from periods prior to the Company's ownership. Excluding the Company's Telios Pharmaceuticals, Inc. subsidiary ("Telios")), approximately $9 million of these NOL's for federal income tax purposes expire between 2001 and 2005. The Company's Telios subsidiary has approximately $84 million of net operating losses, which expire between 2002 and 2010. The amount of Telios' net operating loss that is available and the Company's ability to utilize such loss is dependent on the determined value of Telios at the date of acquisition. The Company's has valuation allowance of $42 million against all deferred tax assets, including the net operating losses, due to the uncertainty of realization. The timing and manner in which these acquired net operating losses may be utilized in any year by the Company are severely limited by the Internal Revenue Code of 1986, as amended, Section 382 and other provisions of the Internal Revenue Code and its applicable regulations.

16. EMPLOYEE BENEFIT PLANS

The Company has a 401(k) Profit Sharing Plan and Trust ("401(k) Plan") for eligible employees and their beneficiaries. The 401(k) Plan provides for employee contributions through a salary reduction election. Employer matching and discretionary profit sharing contributions, which are determined annually by the Company, vest over a six-year period of service. For the years ended December 31, 1999, 1998 and 1997, the Company's matching was based on a percentage of salary reduction elections per eligible participant and totaled $85,000, $48,000 and $35,000, respectively. No discretionary profit sharing contribution was made in any year.

The Company received shareholder approval for its Employee Stock Purchase Plan ("ESPP") in May 1998. The purpose of the ESPP is to provide eligible employees of the Company and certain of its subsidiary corporations with the opportunity to acquire shares of common stock at periodic intervals by means of accumulated payroll deductions. Under the ESPP, a total of 500,000 shares of common stock have been reserved for issuance. These shares will be made available either from the Company's authorized but unissued shares of common stock or from shares of common stock reacquired by the Company as treasury shares.

17. DEVELOPMENT, LICENSE AND ROYALTY AGREEMENTS

The Company has various development funding agreements and grant awards under which it receives payments to support research and development activities. Significant development funding and grant awards include;

A strategic alliance with Johnson & Johnson Medical, Inc. that provides for annual research funding for INTEGRA(R) Artificial Skin beginning in 2000 and additional payments upon the occurrence of certain clinical and regulatory events and for funding expansion of the Company's INTEGRA(R) Artificial Skin production capacity as certain sales targets are achieved (See Note 4).

A strategic alliance with Johnson & Johnson Professional, Inc. (now known as "DePuy") to develop and market a new product to regenerate articular cartilage. The Company will develop an absorbable, collagen-based implant designed in combination with a proprietary RGD peptide. DePuy will develop the arthroscopic instrumentation used in the surgery and will market the combined products worldwide. Under the terms of the agreement, DePuy will make payments up to $13 million as the Company meets various milestones, and will fund all necessary development costs beyond the pre-clinical phase. Following successful development, the Company will be responsible for manufacturing the product and for future new product development. The Company received $300,000 and $1,000,000 in development funding for research and development expenditures under the agreement in 1999 and 1998, respectively which were recorded as Other revenue.

17. DEVELOPMENT, LICENSE AND ROYALTY AGREEMENTS, continued

A three-year, $2 million Department of Commerce award under the National Institute of Standards and Technology ("NIST") program for continued work on a class of biodegradable polymers licensed from Rutgers University. This second award began in April 1998 and the Company received $727,000 and $337,000 of funding for research and development expenditures under it in 1999 and 1998, respectively.

In connection with an agreement with Genetics Institute, Inc. ("GI"), the Company receives development support payments from GI to support development of specialized delivery matrices for the release of GI's recombinant human bone morphogenic protein (rhBMP-2) to simulate bone growth. The Company received $300,000 and $64,000 of funding for research and development expenditures under the agreement in 1999 and 1998, respectively, which were recorded as Other revenue.

In March 1998, the Company entered into a series of agreements with Century Medical, Inc ("CMI"), a wholly-owned subsidiary of ITOCHU Corporation, under which CMI will distribute the Company's identified neurosurgical products in Japan. CMI made an up-front non-refundable payment as partial reimbursement of research and development costs previously expended by the Company of $1.0 million in the first quarter of 1998, which was recorded in Other revenue, and agreed to underwrite the costs of the Japanese clinical trials and regulatory approval processes.

In January 1996, the Company and Cambridge Antibody Technology Limited ("CAT") entered into an agreement consisting of a license to CAT of certain rights to use anti-TGF-(beta) antibodies for the treatment of fibrotic diseases and the granting of a right of first refusal to CAT for certain rights relating to decorin, a molecule believed to mediate the production of TGF-(beta) in humans and animals. The Company will receive royalties upon the sale by CAT of licensed products other than those directed at dermal applications.

As consideration for certain technology, manufacturing, distribution and selling rights and licenses granted to the Company, the Company has agreed to pay royalties on the sales of products that are commercialized relative to the granted rights and licenses. Royalty payments under these agreements by the Company were not significant for any of the periods presented.

18. LEGAL MATTERS

Various lawsuits claims and proceedings are pending or have been settled by the Company. The most significant of those are described below.

In 1997, the Company and the Massachusetts Institute of Technology ("MIT") filed a patent infringement lawsuit against LifeCell Corporation ("LifeCell"). LifeCell filed various counterclaims and a complaint against the Company and MIT claiming tortious interference, business and product disparagement, unfair competition among other charges. In 1998, the Company and LifeCell entered into a settlement agreement under the terms of which the Company agreed not to assert certain patents against LifeCell's current technology or reasonable equivalents thereof and LifeCell acknowledged the validity of these patents. As part of the settlement agreement, the Company purchased LifeCell common stock for $500,000, and LifeCell agreed to a royalty-bearing license for any possible future biomaterials-based matrix products developed by LifeCell that may be covered by the patents.

In 1995, the Company's subsidiary filed a complaint against a distributor claiming the distributor breached a distribution agreement by, among other things, not paying the Company's subsidiary for certain products delivered. In 1998, the Company and the distributor entered into a settlement agreement in which the distributor agreed to pay an aggregate of $550,000 in installments over the remainder of 1998. The Company recorded a net gain in other income in 1998 of $550,000 as a result of the settlement.

18. LEGAL MATTERS, continued

In July 1996, the Company filed a patent infringement lawsuit in the United States District Court in San Diego against Merck KGaA, a German corporation, Scripps Research Institute, a California nonprofit corporation, and David A. Cheresh, Ph.D., a research scientist with Scripps seeking damages and injunctive relief. The complaint charged, among other things, that the defendant Merck KGaA willfully and deliberately induced, and continues to willfully and deliberately induce, defendants Scripps Research Institute and Dr. David A. Cheresh to infringe certain of the Company's patents. These patents are part of a group of patents granted to The Burnham Institute and licensed by the Company that are based on the interaction between a family of cell surface proteins called integrins and the arginine-glycine-aspartic acid (known as "RGD") peptide sequence found in many extracellular matrix proteins. The defendants filed a countersuit asking for an award of defendants' reasonable attorney fees.

Bruce D. Butler, Ph.D., Bruce A. McKinley, Ph.D., and C. Lee Parmley (the "Optex Claimants"), each parties to a Letter Agreement (the "Letter Agreement") with Camino NeuroCare, Inc. ("Camino") dated as of December 18, 1996, have alleged that Camino breached the terms of the Letter Agreement prior to our acquisition of the NeuroCare Group (Camino's prior parent company). The Letter Agreement contains arbitration provisions and Integra and the Optex Claimants have agreed to negotiate rather than seek arbitration for a limited time. While we believe that Camino has valid legal and factual defenses, the Optex Claimants have asserted unspecified significant damages, and we believe that the Optex Claimants are likely to pursue arbitration under the Letter Agreement if the matter is not settled otherwise. We cannot predict the outcome of such an arbitration, were it to take place. In addition, we have asserted a right to indemnification from the seller of the NeuroCare businesses, but there can be no assurance that indemnification, if any, will be obtained.

The Company is also subject to other claims and lawsuits in the ordinary course of its business. In the opinion of management, such other claims are either adequately covered by insurance or otherwise indemnified, and are not expected, individually or in the aggregate, to result in a material adverse effect on the financial condition of the Company. The Company's financial statements do not reflect any material amounts related to possible unfavorable outcomes of the matters above or others. However, it is possible that the Company's results of operations, financial position and cash flows in a particular period could be materially affected by these contingencies.

19. SEGMENT INFORMATION AND MAJOR CUSTOMER DATA

Integra develops, manufactures and markets medical devices, implants and biomaterials. Our operations consist of (1) Integra NeuroSciences, which is a leading provider of implants, instruments, and monitors used in neurosurgery, neurotrauma, and related critical care and (2) Integra LifeSciences, which develops and manufactures a variety of medical products and devices, including products based on our proprietary tissue regeneration technology which are used to treat soft tissue and orthopedic conditions. Integra NeuroSciences sells primarily through a direct sales organization and Integra LifeSciences sells primarily through strategic alliances and distributors.

In 1998, the Company's operations were comprised of two reportable business segments, (1) medical products and (2) skin defects and burns. As a result of a repositioning of the Company's business in 1999, including the sale of a product line, the NeuroCare acquisition, and the transfer of all INTEGRA(R) Artificial Skin sales and marketing activities to JJM, the Company has reorganized its reportable segments into two segments, Integra NeuroSciences and Integra LifeSciences. A majority of the products in the Integra NeuroSciences segment were acquired in the NeuroCare acquisition. Prior to the reorganization, the Company's Integra NeuroSciences business was included in the former medical products segment. The non-neurosurgical business of the former medical products segment and the products sold under the former skin defects and burns segment are now reported in the Integra LifeSciences segment, as the majority of this segment's products are sold under marketing or distribution arrangements.

19. SEGMENT INFORMATION AND MAJOR CUSTOMER DATA, continued

Selected financial information on the Company's business segments is reported below (in thousands):

| | Integra LifeSciences | Integra NeuroSciences | Total Reportable Segments | Corporate | Total |
|---|---|---|---|---|---|
| 1999 | | | | | |
| Sales | $ 17,292 | $ 22,369 | $ 39,661 | $ -- | $ 39,661 |
| Total revenue | 19,671 | 22,819 | 42,490 | -- | 42,490 |
| Operating costs | 21,578 | 27,128 | 48,706 | 6,164 | 54,870 |
| Operating loss | (1,907) | (4,309) | (6,216) | (6,164) | (12,380) |
| 1998 | | | | | |
| Sales | 14,076 | -- | 14,076 | -- | 14,076 |
| Total revenue | 16,428 | 1,027 | 17,455 | -- | 17,455 |
| Operating costs | 22,337 | 2,010 | 24,347 | 7,288 | 31,635 |
| Operating loss | (5,909) | (983) | (6,892) | (7,288) | (14,180) |
| 1997 | | | | | |
| Sales | 14,001 | -- | 14,001 | -- | 14,001 |
| Total revenue | 14,696 | 50 | 14,746 | -- | 14,746 |
| Operating costs | 19,599 | 450 | 20,049 | 13,608 | 33,657 |
| Operating loss | (4,903) | (400) | (5,303) | (13,608) | (18,911) |

Product sales and the related cost of product sales between segments are eliminated into computing segment operating results. Research and development expense is allocated to segments based on a specific identification of program costs within each segment. The Company allocates specifically identifiable general and administrative expenses such as regulatory and legal expense items to the segments, with the remaining activities reflected as corporate activities. The Company does not disaggregate nonoperating revenues and expenses nor identifiable assets on a segment basis.

Two customers accounted each for 15% and 12% of product sales in 1998 and 13% and 11% of product sales in 1997, respectively.

For the years ended December 31, 1999, 1998 and 1997, the Company's foreign export sales, primarily to Europe and the Asia Pacific regions, were 23%, 16% and 14% of total product sales, respectively. Substantially all of the Company's long-lived assets are located in the United States and Puerto Rico.

The Company's product sales consists of several products that make up a large percentage of the total, including the Company's INTEGRA(R) Artificial Skin product which accounted for 9%, 41% and 43% of product sales for the years ended December 31, 1999, 1998 and 1997, respectively.

## 20. SUBSEQUENT EVENTS

The Company purchased the business, including certain assets and liabilities, of Clinical Neuro Systems ("CNS") on January 17, 2000 for $6.8 million. CNS designs, manufactures and sells neurosurgical external ventricular drainage systems including catheters and drainage bags, as well as cranial access kits. The CNS acquisition was financed with $4.0 million in cash and a two-year $2.8 million note payable to the seller.

In connection with the Company's patent infringement lawsuit brought against Merck KgaA and other parties, the Company was awarded $15.0 million in damages on March 17, 2000 by the jury, which found that Merck KgaA had willfully induced infringement of the Company's patents. This award may be adjusted by the court. The Company expects that post-trial motions will be filed, and that Merck KgaA will appeal various decisions of the court and request a new trial, a reduction in damages, or a judgment as a matter of law notwithstanding the verdict. No amounts for this verdict have been reflected in the Company's financial statements.

On March 21, 2000, the Company agreed to purchase the Selector(R) Ultrasonic Aspirator, Ruggles(TM) hand-held neurosurgical instruments and cryosurgery product lines, including certain assets and liabilities, from NMT Medical, Inc. for $12.0 million in cash. The completion of this transaction is subject to customary closing conditions and is expected to close early in the second quarter of 2000.

On March 29, 2000, the Company issued 54,000 shares of Series C Preferred Stock ("Series C Preferred") and warrants to purchase 300,000 shares of common stock at $9.00 per share to affiliates of Soros Private Equity Partners LLC for $5.4 million. The Series C Preferred is convertible into 600,000 shares of common stock and has a liquidation preference of $5.4 million with a 10% cumulative dividend. The Series C Preferred was issued with a beneficial conversion feature that resulted in a nonrecurring non-cash dividend of $4.2 million that will be reflected in earnings (loss) per share applicable to common stock in the first quarter of 2000.

## REPORT OF INDEPENDENT ACCOUNTANTS ON FINANCIAL STATEMENT SCHEDULES

To the Board of Directors and
Stockholders of Integra LifeSciences
Holdings Corporation and Subsidiaries:

Our audits of the consolidated financial statements referred to in our report dated March 1, 2000, (except for Note 20, as to which the date is March 29, 2000) appearing in the 1999 Annual Report on Form 10-K of Integra LifeSciences Holdings Corporation and Subsidiaries (the "Company") also included an audit of the financial statement schedules listed in the index in Item 14 of this Form 10-K. In our opinion, this financial statement schedules presents fairly, in all material respects, the information required to be included therein when read in conjunction with the related consolidated financial statements.

PRICEWATERHOUSECOOPERS LLP

Florham Park, New Jersey
March 1, 2000

INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES
CONDENSED FINANCIAL INFORMATION OF REGISTRANT
SCHEDULE I

BALANCE SHEETS

| | December 31, 1999 | December 31, 1998 |
|---|---|---|
| | (in thousands) | |
| ASSETS | | |
| Investments in and advances to consolidated Subsidiaries.......... | $ 37,989 | $ 31,366 |
| Total assets.......................... | $ 37,989 | $ 31,366 |
| STOCKHOLDERS' EQUITY | | |
| Preferred stock, Preferred stock, $.01 par value (15,000 authorized shares; 500 Series A Convertible shares issued and outstanding at December 31, 1999 and 1998, $4,000 liquidation preference; 100 Series B Convertible shares issued and outstanding at December 31, 1999, $10,000 with a 10% compounded annual cumulative dividend liquidation preference)... | 6 | 5 |
| Common stock, $.01 par value (60,000 authorized shares; 16,131 and 15,783 issued and outstanding at December 31, 1999 and 1998, respectively).................... | 161 | 158 |
| Additional paid-in capital............ | 132,340 | 119,999 |
| Treasury stock, at cost (1 and 52 shares at December 31, 1999 and 1998, respectively)................ | (7) | (286) |
| Unearned compensation related to stock options...................... | (108) | (148) |
| Notes receivable - related party...... | (35) | (35) |
| Accumulated other comprehensive loss.. | (64) | (40) |
| Accumulated deficit................ | (94,304) | (88,287) |
| Total stockholders' equity............ | $ 37,989 | $ 31,366 |

See notes to consolidated financial statements

INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES
CONDENSED FINANCIAL INFORMATION OF REGISTRANT
STATEMENTS OF OPERATIONS

| | For the years ended December 31, | | |
|---|---|---|---|
| | 1999 | 1998 | 1997 |
| | (in thousands) | | |
| Equity in loss of consolidated subsidiaries.. | $ (5,966) | $ (12,342) | $ (16,964) |
| Net loss.................................... | $ (5,966) | $ (12,342) | $ (16,964) |
| Basic and diluted loss per share............ | $ (0.40) | $ (0.77) | $ (1.15) |

INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES
CONDENSED FINANCIAL INFORMATION OF REGISTRANT

STATEMENTS OF CASH FLOWS

| | For the years ended December 31, | | |
|---|---|---|---|
| | 1999 | 1998 | 1997 |
| | (in thousands) | | |
| INVESTING ACTIVITIES: | | | |
| Proceeds from sales of product line and Other assets............................ | $ 6,354 | $ -- | $ -- |
| Capital contribution to consolidated subsidiary............................... | (16,153) | -- | -- |
| Other investing activities.................. | (2,480) | (3,762) | (358) |
| Cash flows used in investing activities...... | (12,279) | (3,762) | (358) |
| FINANCING ACTIVITIES: | | | |
| Proceeds from sales of preferred stock....... | 9,942 | 4,000 | -- |
| Other financing activities, net............. | 2,337 | (238) | 358 |
| Cash flows provided by financing activities.. | 12,279 | 3,762 | 358 |
| Net increase (decrease) in cash and cash equivalents.............................. | -- | -- | -- |
| Cash and cash equivalents at beginning of period.................................. | -- | -- | -- |
| Cash and cash equivalents at end of period... | $ -- | $ -- | $ -- |

See notes to consolidated financial statements

Notes to Financial Statement Schedule

1. The Company did not receive any cash dividends from its consolidated subsidiaries in any period presented.

2. The Company's investments in and advances to subsidiaries are recorded using the equity method of accounting.

INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES
VALUATION AND QUALIFYING ACCOUNTS
SCHEDULE II

| Column A | Column B | Column C | | Column D | Column E |
|---|---|---|---|---|---|
| Description | Balance at Beginning Of Period | Charged to Costs and Expenses | Charged to Other Accounts | Deductions | Balance at End of Period |
| Year ended December 31, 1999 | | | | | |
| Allowance for doubtful Accounts............ | $ 354 | $ 406 | $ 216 | $ (32) | $ 944 |
| Obsolete inventory Reserves............ | 525 | 2,159 | 1,614 | (1,161) | 3,137 |
| Year ended December 31, 1998 | | | | | |
| Allowance for doubtful Accounts............ | $ 390 | $ 76 | $ 15 | $ (127) | $ 354 |
| Obsolete inventory Reserves............ | 1,126 | 522 | 29 | (1,152) | 525 |
| Year ended December 31, 1997 | | | | | |
| Allowance for doubtful Accounts............ | $ 228 | $ 315 | $ -- | $ (156) | $ 390 |
| Obsolete inventory Reserves............ | 548 | 1,413 | -- | (835) | 1,126 |

INTEGRA LIFESCIENCES HOLDINGS CORPORATION

1999 STOCK OPTION PLAN

Section 1

Purpose

This INTEGRA LIFESCIENCES HOLDINGS CORPORATION 1999 STOCK OPTION PLAN (the "Plan") is intended to provide a means whereby Integra LifeSciences Holdings Corporation (the "Company") may, through the grant of incentive stock options and non-qualified stock options (collectively, "Options") to purchase common stock of the Company, par value $0.01 per share ("Common Stock") to Key Employees and Associates (both as defined in Section 3 hereof), attract and retain such Key Employees and Associates and motivate them to exercise their best efforts on behalf of the Company, any Related Corporation (as defined below), or any affiliate of the Company or a Related Corporation.

For purposes of the Plan, a "Related Corporation" shall mean either a "subsidiary corporation" of the Company, as defined in section 424(f) of the Internal Revenue Code of 1986, as amended ("Code"), or the "parent corporation" of the Company, as defined in section 424(e) of the Code. Further, as used in the Plan (a) the term "ISO" shall mean an Option which qualifies as an incentive stock option within the meaning of section 422 of the Code; and (b) the term "NQSO" shall mean an Option which does not qualify as an incentive stock option.

Section 2

Administration

The Plan shall be administered by the Company's Stock Option Committee (the "Committee"), which shall consist solely of not fewer than two directors of the Company, who shall be appointed by, and shall serve at the pleasure of, the Company's Board of Directors (the "Board") (taking into consideration the rules under Section 16(b) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") and the requirements of Section 1621(m) of the Code). In the event a committee has not been established in accordance with the preceding sentence, or cannot be constituted to vote on the grant of an Option, the "Committee" shall consist of the entire Board. Each member of such Committee, while serving as such, shall be deemed to be acting in his capacity as a director of the Company.

The Committee shall have full authority, subject to the terms of the Plan, to select the Key Employees and Associates (both as defined in Section 3 hereof) to be granted ISOs and/or NQSOs under the Plan, to grant Options on behalf of the Company, and to set the date of grant and the other terms of such Options. The Committee may correct any defect, supply any omission and reconcile any inconsistency in this Plan and in any Option granted hereunder in the manner and to the extent it shall deem desirable. The Committee also shall have the authority to establish such rules and regulations, not inconsistent with the provisions of the Plan, for the proper administration of the Plan, and to amend, modify or rescind any such rules and regulations, and to make such determinations and interpretations under, or in connection with, the Plan, as it deems necessary or advisable. All such rules, regulations,

determinations and interpretations shall be binding and conclusive upon the Company, its stockholders and all officers and employees and former officers and employees, and upon their respective legal representatives, beneficiaries, successors and assigns, and upon all other persons claiming under or through any of them. Except as otherwise required by the bylaws of the Company or by applicable law, no member of the Board or the Committee shall be liable for any action or determination made in good faith with respect to the Plan or any Option granted under it.

SECTION 3

Eligibility

(a) In General. Key Employees and Associates shall be eligible to receive Options under the Plan. Key Employees and Associates who have been granted an Option under the Plan shall be referred to as "Optionees." More than one Option may be granted to an Optionee under the Plan.

(b) Key Employees. "Key Employees" are officers, executives, and managerial and non-managerial employees of the Company, a Related Corporation, or an affiliate of the Company or a Related Corporation who are selected by the Committee to receive Options. Key Employees of the Company and/or a Related Corporation shall be eligible to receive ISOs and/or NQSOs. Key Employees of an affiliate shall be eligible to receive only NQSOs.

(c) Associates. "Associates" are designated non-employee directors, consultants and other persons providing services to the Company, a Related Corporation, or an affiliate of the Company or a Related Corporation. Associates shall be eligible to receive only NQSOs.

SECTION 4

Stock

The maximum number of shares of Common Stock that may be issued under Options granted under the Plan shall be 2,000,000; provided, however, that no Key Employee shall receive Options for more than 1,000,000 shares of Common Stock over any one-year period. However, both limits in the preceding sentence shall be subject to adjustment as hereinafter provided. Shares issuable under the Plan may be authorized but unissued shares or reacquired shares, and the Company may purchase shares required for this purpose, from time to time, if it deems such purchase to be advisable.

If any Option granted under the Plan expires or otherwise terminates for any reason whatsoever (including, without limitation, the Optionee's surrender thereof) without having been exercised, the shares subject to the unexercised portion of such Option shall continue to be available for the granting of Options under the Plan as fully as if such shares had never been subject to an Option; provided, however, that (a) if an Option is cancelled, the shares of Common Stock covered by the cancelled Option shall be counted against the maximum number of shares specified above for which Options may be granted to a single Key Employee, and (b) if the exercise price of an Option is reduced after the date of grant, the transaction shall be treated as a cancellation of the original Option and the grant of a new Option for purposes of counting the maximum number of shares for which Options may be granted to a Key Employee.

## SECTION 5

### Granting of Options

From time to time until the expiration or earlier suspension or discontinuance of the Plan, the Committee may, on behalf of the Company, grant to Key Employees and Associates under the Plan such Options as it determines are warranted, subject to the limitations of the Plan; provided, however, that grants of ISOs and NQSOs shall be separate and not in tandem, and further provided that Key Employees of an affiliate and Associates shall not be eligible to receive ISOs under the Plan. A member of the Committee shall not participate in a vote approving the grant of an Option to himself or herself to the extent provided under the laws of Delaware governing corporate self-dealing. The granting of an Option under the Plan shall not be deemed either to entitle the Key Employee or Associate to, or to disqualify the Key Employee or Associate from, any participation in any other grant of Options under the Plan. In making any determination as to whether a Key Employee or Associate shall be granted an Option, the type of Option to be granted, and the number of shares to be covered by such Option, the Committee shall take into account the duties of the Key Employee or Associate, his or her present and potential contributions to the success of the Company, a Related Corporation, or an affiliate of the Company or a Related Corporation, the tax implications to the Company and the Key Employee or Associate of any Option granted, and such other factors as the Committee shall deem relevant in accomplishing the purposes of the Plan. Moreover, the Committee may provide in the Option that said Option may be exercised only if certain conditions, as determined by the Committee, are fulfilled.

## Section 6

### Annual Limit

(a) ISOs. The aggregate Fair Market Value (determined as of the date the ISO is granted) of the Common Stock with respect to which ISOs are exercisable for the first time by a Key Employee during any calendar year (counting ISOs under this Plan and incentive stock options under any other stock option plan of the Company or a Related Corporation) shall not exceed $100,000. The term "Fair Market Value" shall mean the value of the shares of Common Stock arrived at by a good faith determination of the Committee and shall be:

(1) The quoted closing price on the last business day prior to the specified date, if there is a market for the Common Stock on a registered securities exchange or in an over-the-counter market;

(2) The weighted average of the quoted closing prices on the nearest date before and the nearest date after the last business day prior to the specified date, if there are no sales on such day but there are such sales on dates within a reasonable period both before and after such date;

(3) The mean between the bid and asked prices, as reported by the National Quotation Bureau on the specified date, if actual sales are not available during a reasonable period beginning before and ending after the specified date; or

(4) If (1) through (3) above are not applicable, such other method of determining Fair Market Value as shall be authorized by the Code, or the rules or regulations thereunder, and adopted by the Committee.

Where the Fair Market Value of shares of Common Stock is determined under (2) above, the average of the quoted closing prices on the nearest date before and the nearest date after the last business day prior to the specified date shall be weighted inversely by the respective numbers of trading days between the dates of reported sales and such date (i.e., the valuation date), in accordance with Treas. Reg. ss. 20.2031-2(b)(1), or any successor thereto.

(b) Options Over Annual Limit. If an Option intended as an ISO is granted to a Key Employee of the Company or a Related Corporation and such Option may not be treated in whole or in part as an ISO pursuant to the limitation in Subsection (a) above, such Option shall be treated as an ISO to the extent it may be so treated under such limitation and as an NQSO as to the remainder. For purposes of determining whether an ISO would cause such limitation to be exceeded, ISOs shall be taken into account in the order granted.

(c) NQSOs. The annual limits set forth above for ISOs shall not apply to NQSOs.

## SECTION 7

### Option Agreements - Other Provisions

Options granted under the Plan shall be evidenced by written documents ("Option Agreements") in such form as the Committee shall, from time to time, approve. An Option Agreement shall specify whether the Option is an ISO or NQSO; provided, however, if the Option is not designated in the Option Agreement as an ISO or NQSO, the Option shall constitute an ISO if it complies with the terms of section 422 of the Code, and otherwise, it shall constitute an NQSO. Each Optionee shall enter into, and be bound by, such Option Agreements, as soon as practicable after the grant of an Option.

In connection with the grant of any Option, the associated Option Agreement may, in the discretion of the Committee, modify or vary any of the terms of this Plan, including, without limitation, the terms relating to the vesting and exercise of Options, both in general and upon termination of employment or service, disability, and death, the terms relating to the number of shares issuable upon the exercise of outstanding Options and the treatment of Options upon the occurrence of certain corporate transactions; provided, however, that any increase in the maximum number of shares which may be granted to an individual in a one-year period pursuant to the Plan shall require such shareholder approval as may be then required under the applicable rules and regulations under the Code, and that with respect to any grant of an Option which is intended to be an ISO the terms of the Plan, as in effect on the date hereof or subsequently amended, and not the terms of the applicable Option Agreement, shall control. In all other cases, in the event of any inconsistency or conflict between an Option Agreement approved by the Committee and this Plan, the terms of the Option Agreement shall control to the extent provided in the Option Agreement. No Option Agreement may be amended except in a writing executed by a duly authorized officer of the Company and the Optionee or his or her permitted successors and assigns.

SECTION 8

Terms and Conditions of Options

Options granted pursuant to the Plan shall include expressly or by reference the following terms and conditions, as well as such other provisions not inconsistent with the provisions of this Plan and, for ISOs granted under this Plan, the provisions of section 422(b) of the Code, as the Committee shall deem desirable:

(a) Number of Shares. A statement of the number of shares to which the Option pertains.

(b) Price. A statement of the Option price which shall be determined and fixed by the Committee in its discretion, but shall not be less than the higher of 100% (110% in the case of ISOs granted to more than 10% shareholders as discussed in Subsection (j) below) of the fair market value of the optioned shares of Common Stock, or the par value thereof, on the date the Option is granted.

(c) Term.

(1) ISOs. Subject to earlier termination as provided in Subsections (e), (f) and (g) below and in Section 9 hereof, the term of each ISO shall be not more than ten years (five years in the case of more than 10% shareholders as discussed in Subsection (j) below) from the date of grant.

(2) NQSOs. Subject to earlier termination as provided in Subsections (e), (f) and (g) below and in Section 9 hereof, the term of each NQSO shall be not more than ten years from the date of grant.

(d) Exercise.

(1) General. Options shall be exercisable in such installments and on such dates, not less than three months from the date of grant, as the Committee may specify, provided that:

(A) in the case of new Options granted to an Optionee in replacement for options (whether granted under the Plan or otherwise) held by the Optionee, the new Options may be made exercisable, if so determined by the Committee, in its discretion, at the earliest date the replaced options were exercisable, but not earlier than three months from the date of grant of the new Options; and

(B) the Committee may accelerate the exercise date of any outstanding Options, in its discretion, if it deems such acceleration to be desirable.

Any exercisable Option may be exercised at any time up to the expiration or termination of the Option. Exercisable Options may be exercised, in whole or in part, from time to time by giving written notice of exercise to the Company at its principal office, specifying the number of shares to be purchased and accompanied by payment in full of the aggregate Option exercise price for such shares (except that, in the case of an exercise arrangement approved by the Committee and described in Paragraph 2(B)(iv) below, payment may be made as soon as practicable after the exercise). Only full

shares shall be issued under the Plan, and any fractional share which might otherwise be issuable upon exercise of an Option granted hereunder shall be forfeited.

(2) Manner of Payment. The Option price shall be payable:

(A) in cash or its equivalent;

(B) in the case of an ISO, if the Committee in its discretion causes the Option Agreement so to provide, and in the case of an NQSO, if the Committee in its discretion so determines at or prior to the time of exercise:

(i) in Common Stock previously acquired by the Optionee; provided that if such shares of Common Stock were acquired through the exercise of an incentive stock option and are used to pay the Option price of an ISO, such shares have been held by the Optionee for a period of not less than the holding period described in section 422(a)(1) of the Code on the date of exercise, or if such shares of Common Stock were acquired through exercise of a non-qualified stock option and are used to pay the option price of an ISO, or if such shares of Common Stock were acquired through the exercise of an incentive stock option or non-qualified stock option and are used to pay the Option price of an NQSO, such shares have been held by the Optionee for a period of more than 12 months on the date of exercise;

(ii) in Common Stock newly acquired by the Optionee upon exercise of such Option (which shall constitute a disqualifying disposition in the case of an ISO);

(iii) in the discretion of the Committee, in any combination of (A), (B)(i) and/or (B)(ii) above; or

(iv) by delivering a properly executed notice of exercise of the Option to the Company and a broker, with irrevocable instructions to the broker promptly to deliver to the Company the amount of sale or loan proceeds necessary to pay the exercise price of the Option.

In the event the Option price is paid, in whole or in part, with shares of Common Stock, the portion of the Option price so paid shall be equal to the Fair Market Value on the date of exercise of the Option of the Common Stock surrendered in payment of such Option price.

(e) Termination of Employment or Service. If an Optionee's employment by or service with the Company (and Related Corporations and affiliates) is terminated by either party prior to the expiration date fixed for his or her Option for any reason other than death or disability, such Option may be exercised, to the extent of the number of shares with respect to which the Optionee could have exercised it on the date of such termination, or to any greater extent permitted by the Committee, by the Optionee at any time prior to the earlier of (i) the expiration date specified in such Option, or (ii) an accelerated termination date determined by the Committee, in its discretion, except that, subject to Section 9 hereof, such accelerated termination date shall not be earlier than the date of the Optionee's termination of employment or service, and shall not be later than one year after the date of the Optionee's termination of employment or service.

(f) Exercise upon Disability of Optionee. If an Optionee shall become disabled (within the meaning of section 22(e)(3) of the Code) during his or her employment by or service with the Company (and Related Corporations and affiliates) and, prior to the expiration date fixed for his or her Option, his or her employment or service is terminated as a consequence of such disability, such

Option may be exercised, to the extent of the number of shares with respect to which the Optionee could have exercised it on the date of such termination, or to any greater extent permitted by the Committee, by the Optionee at any time prior to the earlier of (i) the expiration date specified in such Option, or (ii) an accelerated termination date determined by the Committee, in its discretion, except that, subject to Section 9 hereof, such accelerated termination date shall not be earlier than the date of the Optionee's termination of employment or service by reason of disability, and shall not be later than one year after the date of the Optionee's termination of employment or service. In the event of the Optionee's legal disability, such Option may be so exercised by the Optionee's legal representative.

(g) Exercise upon Death of Optionee. If an Optionee shall die during his or her employment by or service with the Company (and Related Corporations and affiliates), and prior to the expiration date fixed for his or her Option, or if an Optionee whose employment or service is terminated for any reason, shall die following his or her termination of employment or service but prior to the earliest of (i) the expiration date fixed for his or her Option, (ii) the expiration of the period determined under Subsections (e) and (f) above, or (iii) in the case of an ISO, three months following termination of the Key Employee's employment, such Option may be exercised, to the extent of the number of shares with respect to which the Optionee could have exercised it on the date of his or her death, or to any greater extent permitted by the Committee, by the Optionee's estate, personal representative or beneficiary who acquired the right to exercise such Option by bequest or inheritance or by reason of the death of the Optionee, at any time prior to the earlier of (i) the expiration date specified in such Option or (ii) an accelerated termination date determined by the Committee, in its discretion except that, subject to Section 9 hereof, such accelerated termination date shall not be later than one year after the date of death.

(h) Non-Transferability. No ISO and, except to the extent provided in the related Option Agreement, no NQSO shall be assignable or transferable by the Optionee otherwise than by will or by the laws of descent and distribution, and during the lifetime of the Optionee, the Option shall be exercisable only by him or her or by his or her guardian or legal representative. If the Optionee is married at the time of exercise and if the Optionee so requests at the time of exercise, the certificate or certificates shall be registered in the name of the Optionee and the Optionee's spouse, jointly, with right of survivorship.

(i) Rights as a Stockholder. An Optionee shall have no rights as a stockholder with respect to any shares covered by his or her Option until the issuance of a stock certificate to him or her for such shares.

(j) Ten Percent Shareholder. If, after applying the attribution rules of Section 424(d) of the Code, the Optionee owns more than 10% of the total combined voting power of all shares of stock of the Company or of a Related Corporation at the time an ISO is granted to him or her, the Option price for the ISO shall be not less than 110% of the fair market value of the optioned shares of Common Stock on the date the ISO is granted, and such ISO, by its terms, shall not be exercisable after the expiration of five years from the date the ISO is granted. The conditions set forth in this Subsection (j) shall not apply to NQSOs.

(k) Listing and Registration of Shares. Each Option shall be subject to the requirement that, if at any time the Committee shall determine, in its discretion, that the listing, registration or qualification of the shares covered thereby upon any securities exchange or under any state or federal law, or the consent or approval of any governmental regulatory body, is necessary or desirable as a condition of, or in connection with, the granting of such Option or the purchase of shares

thereunder, or that action by the Company, its shareholders, or the Optionee should be taken in order to obtain an exemption from any such requirement or to continue any such listing, registration, or qualification, no such Option may be exercised, in whole or in part, unless and until such listing, registration, qualification, consent, approval, or action shall have been effected, obtained, or taken under conditions acceptable to the Committee. Without limiting the generality of the foregoing, each Optionee or his or her legal representative or beneficiary may also be required to give satisfactory assurance that such person is an eligible purchaser under applicable securities laws, and that shares purchased upon exercise of an Option are being purchased for investment and not with a view to distribution, and certificates representing such shares may be legended accordingly.

(l) Withholding and Use of Shares to Satisfy Tax Obligations. The obligation of the Company to deliver shares of Common Stock upon the exercise of any Option shall be subject to applicable federal, state and local tax withholding requirements.

If the exercise of any Option is subject to the withholding requirements of applicable tax laws, the Committee, in its discretion (and subject to such withholding rules ("Withholding Rules") as shall be adopted by the Committee), may permit the Optionee to satisfy the withholding tax, in whole or in part, by electing to have the Company withhold (or by returning to the Company) shares of Common Stock, which shares shall be valued, for this purpose, at their Fair Market Value on the date of exercise of the Option (or if later, the date on which the Optionee recognizes ordinary income with respect to such exercise) (the "Determination Date"). An election to use shares of Common Stock to satisfy tax withholding requirements must be made in compliance with and subject to the Withholding Rules. The Committee may not withhold shares in excess of the number necessary to satisfy the minimum income tax withholding requirements. In the event shares of Common Stock acquired under the exercise of an incentive stock option are used to satisfy such withholding requirement, such shares of Common Stock must have been held by the Optionee for a period of not less than the holding period described in section 422(a)(1) of the Code on the Determination Date, or if such shares of Common Stock were acquired through exercise of a non-qualified stock option, such shares were acquired at least 12 months prior to the Determination Date.

## SECTION 9

### Capital Adjustments; Corporate Transactions

The number of shares which may be issued under the Plan, the maximum number of shares with respect to which Options may be granted to any Key Employee under the Plan, both as stated in Section 4 hereof, and the number of shares issuable upon exercise of outstanding Options under the Plan (as well as the Option price per share under such outstanding Options), shall, subject to the provisions of section 424(a) of the Code, be adjusted, as may be deemed appropriate by the Committee, to reflect any stock dividend, stock split, share combination, or similar change in the capitalization of the Company.

In the event of a corporate transaction (such as, for example, a merger, consolidation, acquisition of property or stock, separation, reorganization, or liquidation), each outstanding Option shall be assumed by the surviving or successor corporation; provided, however, that, in the event of a proposed corporate transaction, the Committee may terminate all or a portion of the outstanding Options, effective upon the closing of the corporate transaction, if it determines that such termination is in the best interests of the Company. If the Committee decides to terminate outstanding Options, the Committee shall give each Optionee holding an outstanding Option to be terminated not less than seven days' notice prior to

any such termination by reason of such a corporate transaction, and any such Option which is to be so terminated may be exercised (if and only to the extent that it is then exercisable) up to, and including the date immediately preceding such termination. Further, as provided in Section 8(d) hereof the Committee, in its discretion, may accelerate, in whole or in part, the date on which any or all Options become exercisable.

The Committee also may, in its discretion, change the terms of any outstanding Option to reflect any such corporate transaction, provided that, in the case of ISOs, such change is excluded from the definition of a "modification" under section 424(h) of the Code.

SECTION 9A

Change in Control

Notwithstanding any other provision of the Plan to the contrary, all outstanding Options shall become fully vested and exercisable upon a Change in Control of the Company. "Change in Control" shall mean any of the following events:

(a) An acquisition (other than directly from the Company) of any voting securities of the Company ("Voting Securities") by any "Person" (as such term is used for purposes of section 13(d) or 14(d) of the Exchange Act) immediately after which such Person has "Beneficial Ownership" (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of 50% or more of the combined voting power of all the then outstanding Voting Securities, other than the Company, any trustee or other fiduciary holding securities under any employee benefit plan of the Company or an affiliate thereof, or any corporation owned, directly or indirectly, by the stockholders of the Company in substantially the same proportions as their ownership of stock of the Company; provided, however, that any acquisition from the Company or any acquisition pursuant to a transaction which complies with clauses (i), (ii) and (iii) of paragraph (c) of this Section 9A shall not be a Change in Control under this paragraph (a);

(b) The individuals who, as of February 25, 1999, are members of the Company's Board of Directors (the "Incumbent Board") cease for any reason to constitute at least two-thirds of the Board of Directors; provided, however, that if the election, or nomination for election by the shareholders, of any new director was approved by a vote of at least two-thirds of the members of the Board of Directors who constitute Incumbent Board members, such new directors shall for all purposes be considered as members of the Incumbent Board as of February 25, 1999; provided further, however, that no individual shall be considered a member of the Incumbent Board if such individual initially assumed office as a result of either an actual or threatened "Election Contest" (as described in Rule 14a-11 promulgated under the Exchange Act) or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board of Directors (a "Proxy Contest") including by reason of any agreement intended to avoid or settle any Election Contest or Proxy Contest;

(c) consummation by the Company of a reorganization, merger, or consolidation or sale or other disposition of all or substantially all of the assets of the Company or the acquisition of assets or stock of another entity (a "Business Combination"), unless immediately following such Business Combination: (i) more than 50% of the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors of (x) the corporation resulting from such Business Combination (the "Surviving Corporation"), or (y) if applicable, a corporation which as a result of such transaction owns the Company or all or substantially all of the Company's assets either directly or through one or more subsidiaries (the "Parent Corporation"), is represented, directly or indirectly, by

Company Voting Securities outstanding immediately prior to such Business Combination (or, if applicable, is represented by shares into which such Company Voting Securities were converted pursuant to such Business Combination), and such voting power among the holders thereof is in substantially the same proportions as their ownership, immediately prior to such Business Combination, of the Company Voting Securities; and (ii) at least a majority of the members of the board of directors of the Parent Corporation (or, if there is no Parent Corporation, the Surviving Corporation) were members of the Incumbent Board at the time of the execution of the initial agreement, or the action of the Board, providing for such Business Combination;

(d) approval by the shareholders of the Company of a complete liquidation or dissolution of the Company; or

(e) acceptance by shareholders of the Company of shares in a share exchange if the shareholders of the Company immediately before such share exchange do not own, directly or indirectly, immediately following such share exchange more than 50% of the combined voting power of the outstanding Voting Securities of the corporation resulting from such share exchange in substantially the same proportion as their ownership of the Voting Securities outstanding immediately before such share exchange.

SECTION 10

Acquisitions

Notwithstanding any other provision of this Plan, Options may be granted hereunder in substitution for options held by directors, key employees, and associates of other corporations who are about to, or have, become Key Employees or Associates of the Company or a Related Corporation as a result of a merger, consolidation, acquisition of assets or similar transaction by the Company or a Related Corporation. The terms, including the option price, of the substitute options so granted may vary from the terms set forth in this Plan to such extent as the Committee may deem appropriate to conform, in whole or in part, to the provisions of the options in substitution for which they are granted.

SECTION 11

Amendment or Replacement of Outstanding Options

The Committee shall have the authority to effect, at any time and from time to time, with the consent of the affected Optionees, the cancellation of any or all outstanding Options under the Plan and to grant in substitution therefor new Options under the Plan covering the same or a different number of shares of Common Stock but having a per share purchase price not less than the greater of par value or 100% of the Fair Market Value of a share of Common Stock on the new date of the grant. The Committee may permit the voluntary surrender of all or a portion of any Option to be conditioned upon the granting to the Optionee under the Plan of a new Option for the same or a different number of shares of Common Stock as the Option surrendered, or may require such voluntary surrender as a condition precedent to a grant of a new Option to such Optionee. Any new Option shall be exercisable at the price, during the period, and in accordance with any other terms and conditions specified by the Committee at the time the new Option is granted, all determined in accordance with the provisions of the Plan without regard to the price, period of exercise, and any other terms or conditions of the Option surrendered.

## SECTION 12

### Amendment or Discontinuance of the Plan

The Board from time to time may suspend or discontinue the Plan or, subject to such shareholder approval as may be then required under the applicable rules and regulations of the Code or rules of the exchange or market on which the Common Stock is listed, may amend it in any respect whatsoever. Notwithstanding the foregoing, no such suspension, discontinuance or amendment shall materially impair the rights of any holder of an outstanding Option without the consent of such holder.

## SECTION 13

### Rights

Neither the adoption of the Plan nor any action of the Board or the Committee shall be deemed to give any individual any right to be granted an Option, or any other right hereunder, unless and until the Committee shall have granted such individual an Option, and then his or her rights shall be only such as are provided by the Option Agreement.

Any Option under the Plan shall not entitle the holder thereof to any rights as a stockholder of the Company prior to the exercise of such Option and the issuance of the shares pursuant thereto. Further, notwithstanding any provisions of the Plan or the Option Agreement with an Optionee, the Company shall have the right, in its discretion, to retire an Optionee at any time pursuant to its retirement rules or otherwise to terminate his or her employment or service at any time for any reason whatsoever.

## SECTION 14

### Indemnification of Board and Committee

Without limiting any other rights of indemnification which they may have from the Company and any Related Corporation (and any affiliate), the members of the Board and the members of the Committee shall be indemnified by the Company against all costs and expenses reasonably incurred by them in connection with any claim, action, suit, or proceeding to which they or any of them may be a party by reason of any action taken or failure to act under, or in connection with, the Plan, or any Option granted thereunder, and against all amounts paid by them in settlement thereof (provided such settlement is approved by legal counsel selected by the Company) or paid by them in satisfaction of a judgment in any such action, suit, or proceeding, except a judgment based upon a finding of willful misconduct or recklessness on their part. Upon the making or institution of any such claim, action, suit, or proceeding, the Board or Committee member shall notify the Company in writing, giving the Company an opportunity, at its own expense, to handle and defend the same before such Board or Committee member undertakes to handle it on his own behalf.

## SECTION 15

### Application of Funds

Any cash received in payment for shares upon exercise of an Option to purchase Common Stock shall be added to the general funds of the Company. Any Common Stock received in payment for shares upon exercise of an Option to purchase Common Stock shall become treasury stock.

## SECTION 16

### Shareholder Approval

This Plan shall become effective as of February 25, 1999 (the date the Plan was adopted by the Board); provided, however, that if the Plan is not approved by the Company's shareholders within 12 months before or after said date, the Plan and all Options granted hereunder shall be null and void and no additional options shall be granted hereunder.

## SECTION 17

### No Obligation to Exercise Option

The granting of an Option shall impose no obligation upon an Optionee to exercise such Option.

## SECTION 18

### Termination of Plan

Unless earlier terminated as provided in the Plan, the Plan and all authority granted hereunder shall terminate absolutely at 12:00 midnight on February 24, 2009, which date is within ten years after the date the Plan was adopted by the Board (or the date the Plan was approved by the shareholders of the Company, whichever is earlier), and no Options hereunder shall be granted thereafter. Nothing contained in this Section 18, however, shall terminate or affect the continued existence of rights created under Options issued hereunder and outstanding on February 24, 2009, which by their terms extend beyond such date.

## SECTION 19

### Governing Law

With respect to any ISOs granted pursuant to the Plan and the Option Agreements thereunder, the Plan, such Option Agreements and any ISOs granted pursuant thereto shall be governed by the applicable Code provisions to the maximum extent possible. Otherwise, the laws of the state of Delaware shall govern the operation of, and the rights of Optionees under, the Plan, the Option Agreements and any Options granted thereunder.

# INTEGRA LIFESCIENCES HOLDINGS CORPORATION

## DEFERRED COMPENSATION PLAN

1. Eligibility. Eligibility for the Integra LifeSciences Holdings Corporation Deferred Compensation Plan (the "Plan") shall be limited to the executive officers of Integra LifeSciences Holdings Corporation (the "Company") and its affiliates who constitute a select group of management or highly compensated employees within the meaning of section 201(2) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA") ("Eligible Officers").

2. Terms of Participation.

(a) General Rule. An Eligible Officer may elect to participate in the Plan by signing a Deferred Compensation Agreement (the "Agreement") in the form attached hereto and incorporated by reference herein. An Eligible Officer's participation shall commence on January 1 of the calendar year immediately following the year in which the Eligible Officer executes the Agreement, except that when an Eligible Officer executes an Agreement within 30 days of the Plan's initial effective date or within 30 days of first becoming eligible to participate in the Plan, participation shall commence with respect to services to be performed subsequent to the date of the Agreement. By signing the Agreement, the Eligible Officer agrees to defer any whole percentage (up to 50 percent) of his/her base compensation from the Company and its affiliates with respect to services performed after the date of the Agreement. For purposes of the Plan, "base compensation" means an Eligible Officer's basic salary from the Company and its affiliates, excluding any commissions, bonuses, overtime, or other extra or incentive pay.

(b) Termination of Participation. Participation in the Plan shall continue until the Eligible Officer furnishes written notice to the Company that the Eligible Officer terminates his/her participation in the Plan or until such time as the Company terminates the Plan pursuant to Section 7 below. Termination by an Eligible Officer shall be made by written notice delivered or mailed to the Company's Stock Option Committee (the "Committee") (or its delegate) no later than December 31 of the calendar year preceding the calendar year in which such termination is to take effect.

(c) Participation after Terminating Participation. An Eligible Officer who has terminated his/her participation may subsequently elect to participate in the Plan by executing a new Agreement in accordance with subsection (a) above.

(d) Changes in Amounts or Distribution Methods. An Eligible Officer may alter the amount of deferral for any future calendar year, and/or elect a different method by which he/she will receive amounts deferred for future calendar years, if the Eligible Officer and the Company enter into a new Agreement on or before December 31 of the calendar year preceding the calendar year for which the new Agreement is to take effect. For each new Agreement which changes the method of receipt of deferred amounts, a new record account (the "Deferred Compensation Account" or "Account") will be established for the Eligible Officer.

(e) Suspension of Deferrals. Notwithstanding the foregoing, an Eligible Officer may not make deferrals under this Plan during any period for which contributions must be suspended in accordance with Treasury Regulation ss.1.401(k) - 1(d)(2)(iv)(B)(4) as a condition of the Eligible Officer's receipt of a hardship withdrawal from the Company's 401(k) Plan.

3. Establishment of Accounts and Crediting of Deferrals.

(a) Accounts. The Committee shall establish and maintain, or cause to be maintained, for each Eligible Officer who elects to participate in the Plan, a separate Deferred Compensation Account to record the deferrals made by the Eligible Officer under an Agreement. The Committee shall also maintain, or cause to be maintained, a record of the value of the Eligible Officer's interest in such Account.

(b) Investment of Deferrals. Each Eligible Officer shall indicate in his/her Agreement whether he/she would like to have his/her deferrals deemed to be invested in phantom units of the Company's $0.01 par value common stock ("Common Stock") and/or in phantom units of various mutual funds designated by the Committee as available under the Plan ("Mutual Funds"). An Eligible Officer may apportion his/her deferrals among the various investment options in whole percentages. In addition, each Eligible Officer may indicate in his/her Agreement whether he/she would like to have amounts already credited to his/her Account reapportioned among phantom units of Common Stock and/or Mutual Funds.

(c) Allocation of Deferrals; Reapportionment.

(i) Deferrals made by an Eligible Officer under an Agreement shall be invested in phantom units of (and if applicable, fractional phantom units of) Common Stock and/or Mutual Funds, as directed by the Eligible Officer. As of each pay date that deferrals are withheld from an Eligible Officer's compensation, such deferrals shall be converted by the Committee into such phantom units (and, if applicable, fractional units). The amount of the deferrals withheld from the Eligible Officer's compensation on such pay date and designated for a particular investment option shall be divided by the per unit value of phantom units of such investment option on such date, as determined under (d) below. Such phantom units shall be credited to the respective Eligible Officers' Accounts.

(ii) Any reapportionment of amounts already credited to an Eligible Officer's Account(s) shall occur on the first pay date of the calendar year to which the Eligible Officer's Agreement applies.

(d) Valuation of Phantom Units. As of each pay date, the Committee shall determine the fair market value of one share of Common Stock and one share of each Mutual Fund. With respect to the Mutual Funds, and during such time as the Common Stock is listed upon an established stock exchange or market, the per share "fair market value" on any relevant day shall be deemed to be the quoted closing price on the immediately preceding business day. A phantom unit of Common Stock shall be deemed equivalent in value to one share of Common Stock of the Company and a phantom unit of a Mutual Fund shall be deemed equivalent in value to one share of such Mutual Fund. The fair market value of a share and the value of phantom units, as determined by the Committee, shall be conclusive.

(e) Adjustments to Phantom Units of Common Stock. In the event of any change in the outstanding shares of the Common Stock by reason of any stock dividend or split, the Committee shall make appropriate adjustments in the number of phantom units of Common Stock theretofore allocated to Eligible Officers' Accounts. In the event of a corporate transaction, such as a recapitalization, merger, consolidation, separation, reorganization, or similar corporate change, the Plan shall be assumed by the surviving or successor corporation and the Committee (or its successor) shall make appropriate adjustments in the number of phantom units theretofore allocated to Eligible Officers' Accounts. For example, if the Company is acquired by another corporation and shareholders of the Company receive

two shares of the acquirer's stock for each share of Common Stock, the Committee (or its successor) shall convert each phantom unit of Common Stock into two phantom units of the acquirer's stock.

(f) Dividend Payments and Distributions. Each Eligible Officer's Account shall be credited, for each phantom unit of Common Stock and/or each phantom unit of a Mutual Fund in his/her Account, an amount equal to the actual amount of any cash dividend paid on a share of Common Stock of the Company and/or of any cash distribution paid with respect to a share of the Mutual Fund, respectively. A dividend amount on Common Stock shall be reinvested in phantom units of Common Stock on the pay date coinciding with or immediately following the date the dividend amount is credited to the Account. A distribution amount with respect to a Mutual Fund shall be immediately reinvested in phantom units of the Mutual Fund.

(g) No Shareholder Rights. The crediting of phantom units of Common Stock or of a Mutual Fund shall not entitle any Eligible Officer to voting rights or any other rights of a shareholder with respect to such units.

(h) Vesting. An Eligible Officer's interest in amounts and phantom units of Common Stock or of a Mutual Fund credited to his/her Account shall be fully vested and nonforfeitable at all times.

(i) Limit on Number of Units and Shares. Unless this Plan has been approved by the Company's shareholders, the aggregate number of phantom units of Common Stock allocated to Accounts under this Section 3 and of shares of Common Stock distributed under Section 4 hereof shall not exceed 25,000.

(j) Annual Reports. The Committee shall provide each participating Eligible Officer with an annual statement of his/her Deferred Compensation Account balance(s).

4. Distribution.

(a) Form. All distributions of amounts invested in phantom units of Common Stock under the Plan shall be made in the form of Common Stock. An Eligible Officer shall receive one share of Common Stock for each phantom unit of Common Stock credited to his/her Account. However, the value of any fractional phantom unit shall be distributed in cash. Distributions of amounts invested in phantom units of a Mutual Fund shall be made in cash.

(b) General Rule. As of January 31 of the year following the year in which the Eligible Officer dies, retires, resigns, becomes disabled or otherwise ceases to be an employee of the Company and its affiliates, the total amount of phantom units credited to the Eligible Officer's Account under the Plan shall be distributed to the Eligible Officer (or upon his/her death, to his/her designated beneficiary) in accordance with one of the alternatives set forth below:

(i) one single payment; or

(ii) any number of annual installments (as calculated in the following paragraph) for a period of two to 10 years. Installments shall be paid annually as of January 31 until the balance in the Eligible Officer's Account is exhausted.

Selection of a distribution alternative shall be made at the time the Eligible Officer executes the Agreement. Except as provided in the following paragraph, each installment payment, other than the final payment, shall include:

(1) the number of shares of Common Stock shall be equal to 1/n multiplied by the number of phantom units of Common Stock in the Eligible Officer's Account as of the previous December 31, where "n" equals the number of payments yet to be made;

(2) the amount to be paid in cash shall be equal to 1/n multiplied by the value of the phantom units of Mutual Funds in the Eligible Officer's Account as of the previous December 31, where "n" equals the number of payments yet to be made.

The final payment will equal the balance in the Eligible Officer's Account as of the final January 31 payment date, and such payment shall be made as soon as practicable after such date. For example, if payments are to be made in 10 annual installments commencing on January 31, 2000, the first payment shall be equal to 1/10th of the number of phantom units of Common Stock in the Account on December 31, 1999 plus 1/10th of the value of the Mutual Fund phantom units in the Account as of December 31, 1999, the following year's payment would be equal to 1/9th of the number of phantom units of Common Stock on December 31, 2000 plus 1/9th of the value of the Mutual Fund phantom units as of December 31, 2000, etc.

If the total value of Eligible Officer's Account as of the date of the first scheduled payment does not exceed $5,000, the Company shall instead distribute such Account in a single payment as of that date. Further, the Eligible Officer may not select a period of time which will cause the value of an annual payment to be less than $1,000. Notwithstanding the foregoing, in the event the Eligible Officer ceases to be an employee of the Company and its affiliates and becomes a proprietor, officer, partner, or employee of, or otherwise becomes affiliated with, any business or entity that is in competition with the Company or any of its affiliates, the Company reserves the right at the sole discretion of the Committee to make an immediate single payment to the Eligible Officer of the balance of the Eligible Officer's Account at that time.

(c) Hardship Distributions. Notwithstanding the preceding two paragraphs, the Company may at any time make a single payment to the Eligible Officer (or surviving beneficiary) equal to a part or all of the balance in the Eligible Officer's Account upon a showing of an unforeseeable (i.e., unanticipated) financial emergency caused by an event beyond the control of the Eligible Officer (or surviving beneficiary) which would result in severe financial hardship to the Eligible Officer (or surviving beneficiary) if such payment were not made. The determination of whether such emergency exists shall be made at the sole discretion of the Committee (with the Eligible Officer requesting the payment not participating in the discussion or the decision, if he/she is also a member of the Committee). The amount of the payment shall be limited to the amount necessary to meet the financial emergency, and any remaining balance in the Eligible Officer's Account shall thereafter be paid at the time and in the manner otherwise set forth in this Section.

(d) Delay of Payments. Notwithstanding the foregoing, the Committee may delay payment of all or a portion of an amount payable from an Eligible Officer's Account in order to render all such payments deductible by the Company. In addition, if the Committee determines that the listing, registration, or qualification of any Common Stock issuable under the Plan upon any securities exchange or under any state or Federal law, or the consent of any regulatory body, is necessary in connection with the operation of the Plan, the issuance of Common Stock under the Plan may be deferred until such listing, registration, qualification, or consent is obtained.

5. Designation of Beneficiary. An Eligible Officer may designate in writing any person or legal entity as his/her beneficiary to receive any amounts payable from his/her

Account(s) upon his/her death. If there is no beneficiary designation in effect at the Eligible Officer's death or the designated beneficiary does not survive the Eligible Officer, any amounts in the Eligible Officer's Account shall be paid in a single payment to the Eligible Officer's estate. If the designated beneficiary dies after beginning to receive installment payments, any amounts payable from the Eligible Officer's Account shall be paid in a single payment to the beneficiary's estate at the beneficiary's death.

6. Claims Procedure The procedure for presenting claims under the Plan and appealing denials thereof is set forth in this Section 6.

(a) Filing of Claims. Any Eligible Officer or beneficiary (the "claimant") may file a written claim for a Plan benefit with the Committee or its delegate.

(b) Notice of Denial of Claim. In the event of a denial of any benefit requested by any claimant, the claimant shall be given a written notification containing specific reasons for the denial. The written notification shall contain specific reference to the pertinent Plan provisions on which the denial is based. In addition, it shall contain a description of any additional material or information necessary for the claimant to perfect a claim and an explanation of why such material or information is necessary. Further, the notification shall provide appropriate information as to the steps to be taken if the claimant wishes to submit his/her claim for review.

The written notification shall be given to the claimant within 90 days after receipt of his/her claim by the Committee (or its delegate) unless special circumstances require an extension of time for processing, in which case written notice of the extension shall be furnished to the claimant prior to the termination of the original 90-day period, and such notice shall indicate the special circumstances which make the postponement appropriate. In no event may the extension exceed a total of 180 days from the date of the original receipt of the claim.

(c) Right of Review. In the event of a denial of benefits, the claimant shall be permitted to review the pertinent documents and to submit to the Committee (or its delegate) issues and comments in writing. In addition, the claimant may make a written request for a full and fair review of his/her claim and its denial by the Committee (or its delegate). Such written request must be received by the Committee (or its delegate) within 60 days after receipt by the claimant of written notification of the denial of the claim.

(d) Decision on Review

(i) Time Within Which Decision to be Rendered. A decision shall be rendered by the Committee (or its delegate) within 60 days after the receipt of the request for review. However, where special circumstances make a longer period for decision necessary or appropriate, the decision of the Committee (or its delegate) may be postponed on written notice to the claimant (prior to the expiration of the initial 60-day period) for an additional 60 days. In no event shall the decision of the Committee (or its delegate) be rendered more than 120 days after the receipt of the request for review.

(ii) Written Decision Required. Any decision by the Committee (or its delegate) shall be furnished to the claimant in writing in a manner calculated to be understood by the claimant and shall set forth the specific reason(s) for the decision and the specific Plan provision(s) on which the decision is based.

(e) Deemed Denial. If a decision on a claim is not rendered within the time period prescribed in (b) or (d) above, the claim shall be deemed denied.

7. Amendment and Termination of the Plan. The Company reserves the right to amend or terminate the Plan at any time. The balance in the Eligible Officer's Account(s) shall remain subject to the provisions of the Plan and distribution will not be accelerated because of the termination of the Plan.

8. Non-Assignability. The right of the Eligible Officer or any other person to receive payments under this Plan or any Agreement hereunder shall not be subject in any manner to anticipation, alienation, sale, transfer, assignment, pledge, encumbrance, attachment, or garnishment by creditors of the Eligible Officer or any beneficiary.

9. Miscellaneous.

(a) No Funding. The Company shall not be required to fund or secure in any way its obligations hereunder. Nothing in the Plan or in any Agreement hereunder and no action taken pursuant to the provisions of the Plan or of any Agreement hereunder shall be construed to create a trust or a fiduciary relationship of any kind. Payments under the Plan and any Agreement hereunder shall be made when due from the general assets of the Company. Neither an Eligible Officer nor his/her designated beneficiary shall acquire any interest in such assets by virtue of the Plan or any Agreement hereunder. This Plan constitutes a mere promise by the Company to make payments in the future, and to the extent that an Eligible Officer or his/her designated beneficiary acquires a right to receive any payment from the Company under the Plan, such right shall be no greater than the right of any unsecured general creditor of the Company. The Company intends for this Plan to be unfunded for federal income tax purposes and for the purposes of Title I of ERISA.

(b) Administration and Interpretation. The Plan shall be administered by the Committee, which shall consist of at least two directors of the Company, who shall be appointed by, and shall serve at the pleasure of, the Company's Board of Directors (the "Board"). In the event a committee has not been established in accordance with the preceding sentence, the "Committee" shall consist of the entire Board. Each member of such Committee, while serving as such, shall be deemed to be acting in his/her capacity as a director of the Company.

The Committee shall have full power, authority, and discretion to interpret, construe, and administer this Plan and any Agreement hereunder and its interpretation and construction thereof, and actions hereunder, including any determination of eligibility to participate and valuation of an Eligible Officer's Account(s), or the amount or recipients of the payment to be made therefrom, shall be binding and conclusive on all persons for all purposes. The Committee shall not be liable to any person for any action taken or omitted in connection with the interpretation and administration of this Plan and any Agreement hereunder unless attributable to its own willful misconduct or lack of good faith. The Committee shall be the Plan Administrator and the "Named Fiduciary" within the meaning of section 402 of ERISA.

(c) Withholding. To the extent required by law, the Company shall withhold federal or state income or employment taxes with respect to any payments under the Plan or any Agreement hereunder and shall furnish the Eligible Officer (or beneficiary) and the applicable governmental agency or agencies with such reports, statements or information as may be required in connection with such payments. As a condition of receiving a payment under the Plan, the Eligible Officer (or beneficiary) must remit to the Company an amount in cash equal to such amount of income and/or employment taxes required to be withheld, if the cash to be distributed is insufficient to cover the amount required to be withheld.

(d) Incapacity of Payee. If the Committee shall find that any person to whom any payment is payable under this Plan or any Agreement hereunder is unable to care for his/her affairs because of

illness or accident, or is a minor, any payment due (unless a prior claim therefor shall have been made by a duly appointed guardian, committee or other legal representative) may be paid to the spouse, a parent, or a brother or sister, or to any person deemed by the Committee to have incurred expense for the person who is otherwise entitled to payment, in such manner and proportions as the Committee may determine. Any such payment shall serve to discharge the liability of the Company under this Agreement to make payment to the person who is otherwise entitled to payment.

(e) Expenses. All expenses incurred in administering this Plan and any Agreement hereunder shall be paid by the Company.

(f) No Additional Rights. Nothing in this Plan or any Agreement hereunder shall be construed as conferring any right on the part of the Eligible Officer to be or remain an employee of the Company or its affiliates or to receive any particular amount of compensation.

(g) Binding Nature. This Plan and any Agreement hereunder shall be binding upon, and inure to the benefit of, the Company, its successors and assigns, and each Eligible Officer and his/her heirs, executors, administrators, and legal representatives.

(h) Gender and Number. In interpreting the Plan, masculine gender may include the feminine, neuter gender may include the masculine or feminine, and the singular may include the plural, unless the context clearly indicates otherwise.

(i) Headings. The headings of this Plan are for reference only. In the event of a conflict between a heading and the context of the Section or subsection, the content of the Section or subsection shall control.

(j) Governing Law. This Plan and any Agreement hereunder shall be governed by and construed under the laws of the State of Delaware.

(k) Effective Date. This Plan shall be effective as of July 1, 1999.

Exhibit 10.32

PUERTO RICO INDUSTRIAL DEVELOPMENT COMPANY

LEASE CONTRACT

PROJECT No.: T-0810-0-68 &
L-154-2-62-06-0 (LOT #6)
LOCATION : ANASCO, PUERTO RICO

THIS AGREEMENT ENTERED into on June 30, 1994 by: AS "LANDLORD", THE PUERTO RICO INDUSTRIAL DEVELOPMENT COMPANY, AND AS "TENANT", HEYER-SCHULTE NEUROCARE, INC.

WITNESSETH

WHEREAS, LANDLORD is the owner of certain landsite and building, identified in the Epigraph, hereinafter referred to as the Premises. WHEREAS, LANDLORD has agreed to lease to TENANT, and TENANT has agreed to hire from LANDLORD the Premises. NOW THEREFORE, in consideration of the foregoing premises, the parties herein agree on this Lease subject to the following:

TERMS AND CONDITIONS

ONE: LANDLORD hereby demises and lets unto TENANT, and TENANT hereby leases from LANDLORD the Premises which are fully described in Schedule "A" hereto annexed and made a part hereof. The Premises are subject to the encumbrances, liens and/or restrictions, if any, that may appear from said Schedule "A". Furthermore, the air rights of the Premises, are excepted and reserved to LANDLORD.

TWO: Premises shall be used and occupied exclusively in the manufacture of neurosurgical devices and other medical products. (SIC. #03841).

THREE: TENANT shall hold the Premises for a period of ten (10) years to commence on July 1st, 1994. TENANT agrees to accept possession of the demised premises, under the provisions of this Contract, in their present condition and further agrees and undertakes to put them in thorough repair, good order and safe conditions in coordination with LANDLORD'S Maintenance Department as detailed in Schedule "B" hereto annexed and made a part hereof.

FOUR: Commencing on July 1st, 1994, TENANT shall pay to LANDLORD an annual rental of $2.20 per square foot of gross building area during the first sixty (60) months of the term of this lease and of $2.75 per square foot of gross building area during the last sixty (60) months. This rental shall be paid in equal monthly installments of $2,094.64 for the first sixty (60) months and of $2,618.30 for the last sixty (60) months. The monthly installments for rent specified herein, shall be paid in advance on the first day of each month at LANDLORD'S

office, or at any other place that LANDLORD may notify. In the event that the date of commencement does not fall on the first of the month, TENANT further agrees to pay the first partial monthly installments, prior to, or on the date of commencement.

FIVE: Simultaneously herewith TENANT shall deposit with LANDLORD the amount of $3,016.28 in Certified Check.

This deposit shall guarantee the compliance by TENANT of its obligations, under this Contract, particularly, but not limited to, the payment of rent, the compliance of the environmental clauses herein included and the return of the Premises in proper condition at the termination of this Lease. On said termination, if TENANT is not in default of any of the terms and conditions of this Contract, LANDLORD will return to TENANT the sum of money, if any, held pursuant to this provision, after LANDLORD'S Environmental Office certifies that there are not environmental deficiencies as a result of TENANT'S manufacturing operation on the demised Premises.

SIX: TENANT agrees to have on the date of commencement of the term of this Lease a capitalization of $900,000.00 Likewise TENANT agrees to install within six (6) months from the same date manufacturing machinery and equipment with a value of at least $900,000.00. This shall not include the cost of transportation and installation thereof, nor its ordinary depreciation after installation; and within eighteen (18) months from the date of commencement of the term, to employ a minimum of eighty (80) production workers. The aforementioned levels, shall be maintained throughout the term of this Lease or any extension thereof.

SEVEN: All notices, demands, approvals, consents and/or communications herein required or permitted shall be in writing. If by mail should be certified and to the following addresses, to LANDLORD: PO BOX 362350, SAN JUAN, PUERTO RICO 00936-2350. To

TENANT:

| | |
|---|---|
| ANTONIO J. RODRIGUEZ, ESQ. | MR. JOSEPH CELUSAK |
| MCCONNELL & VALDES | HEYER-SCHULTE NEUROCARE, INC. |
| PO BOX 364225 | STATE ROAD 402, KM. 1.2. |
| SAN JUAN, PUERTO RICO 00936-4225 | PO BOX 1386 |
| TELF- (809) 250-5663 | ANASCO, PUERTO RICO 00610 |

EIGHT: Net Lease - This Lease shall be interpreted as a net lease; it being the exclusive responsibility of TENANT to pay for all operating expenses, utilities, maintenance, expenses, insurance, taxes or any other costs, expenses or charges of any nature not specifically assumed by LANDLORD hereunder.

NINE: Warranty as to use - LANDLORD does hereby warrant that at the time of the commencement of the term of this Lease, the Premises may be used by TENANT for the manufacturing purposes herein intended which are deemed consistent with the design and construction in accordance with the corresponding

plans and specifications.

TEN: Alterations - TENANT shall make no alterations, additions or improvements to the Premises without the prior consent of LANDLORD and all such alterations,

additions or improvements made by or for TENANT, shall be at TENANT'S own cost and expenses and shall, when made, be the property of LANDLORD without additional consideration and shall remain upon and be surrendered with the Premises as a part thereof at the expiration or earlier termination of this Lease, subject to any right of LANDLORD to require removal or to remove as provided for hereinafter.

In the event TENANT asks for LANDLORD'S consent for any alteration; LANDLORD may at its option, required from TENANT to submit plans and specifications for said alteration. Before commencing any such work, said plans and specifications, if required, shall be filed with and approved by all governmental agencies having jurisdiction thereof, and the consent of any mortgagee having any interest in or lien upon this Lease shall be procured by TENANT and delivered to LANDLORD if required by the term of the mortgage.

Before commencing any such work, TENANT shall at TENANT'S own cost and expense, deliver to LANDLORD a General Accident Liability Policy more particularly described in Article THIRTY (30) hereof, but said policy shall recite and refer to such work, and in addition thereto, if the estimated cost of such work is more than FIVE THOUSAND DOLLARS ($5,000.00), TENANT shall, at TENANT'S own cost and expense, deliver to LANDLORD a surety bond, or a performance bond from a company acceptable to LANDLORD, or a similar bond or other security satisfactory to LANDLORD, in an amount equal to the estimated cost of such work, guaranteeing the completion of such work within a reasonable time, due regard being had to conditions, free and clear of materialmen liens, mechanics liens or any other kind of lien, encumbrances, chattel mortgages and conditional bills of sale and in accordance with said plans and specifications submitted to and approved by LANDLORD. At LANDLORD'S option TENANT shall provide a blanket written guarantee in an amount sufficient to satisfy LANDLORD as to all alterations, changes, additions and improvements to the Premises n lieu of separate guarantee for each such project.

TENANT shall pay the increased premium, if any, charged by the insurance companies carrying insurance policies on said building, to cover the additional risk during the course of such work.

ELEVEN: Power Substation - If required by TENANT'S operations, TENANT shall, at its own cost and expense, construct and/or install a power substation and connect it to the PUERTO RICO ELECTRICAL POWER AUTHORITY (PREPA) distribution lines, for voltages up to 13.2 KV; and to PREPA transmission lines for voltages of 38 KV, all in conformity to PREPA'S requirements. Such construction shall, in no event, be undertaken by TENANT until after LANDLORD has approved the location thereof, as well as the routing of the power line extension.

TWELVE: Repairs and Maintenance - TENANT shall, at its own cost and expense, put, keep and maintain in thorough repair and good order and safe condition the building and improvements standing upon the Premises at the commencement of the term hereon or thereafter erected upon the premises, or forming part of the Premises, and their full equipment and appurtenances, the side walks areas, sidewalk hoists, railings, gutters, curbs and the like in from of the adjacent to the Premises, and each and every part thereof, both inside and outside, extraordinary and ordinary, and shall repair the whole and each and every part thereof in order to keep the same at all times during the term hereof in through repair and good order and safe conditions, whenever the necessity or desirability therefor may occur, and whether or not the

same shall occur, in whole or in part, by wear, tear, obsolescence or defects, and shall use all reasonable precautions to prevent waste, damage or injury, except as provided hereinafter.

LANDLORD and not TENANT, shall be responsible for and shall promptly correct any defects in the building on the Premises which are due to faulty design, or to errors of construction not apparent at the time the Premises were inspected by TENANT for purposes of occupancy by TENANT; this shall not be interpreted to relieve TENANT of any responsibility or liability herein otherwise provided, including among others, for structural failure due to the fault or negligence of TENANT.

TENANT shall also, at TENANT'S own cost and expense, maintain the landsite in thoroughly clean condition; free from solid waste (which includes liquid and gaseous as defined by the Resource Conservation and Recovery Act), and the Regulation on Hazardous and Non-Hazardous Waste of the Environmental Quality Board, as amended, rubbish, garbage and other obstructions. Specifically, TENANT shall not use said landsite, nor permit it to be used, as a deposit or as dump for raw materials, waste materials, hazardous, toxic or non-toxic substances, or substances of whichever nature. TENANT shall neither make any excavation for the purpose of storing, putting away and/or concealing raw materials or waste materials of any kind. Underground storage of hazardous and/or toxic substances is specifically prohibited.

TENANT shall not do or cause to be done, nor permit on the Premises anything deemed extra hazardous, nor shall it store in the Premises flammable or toxic products of any class or kind without taking the proper precautions and complying with applicable federal and Commonwealth laws and regulations.

In case TENANT needs to store in the landsite raw materials of a hazardous and/or toxic nature or hazardous and/or toxic wastes, TENANT shall notify LANDLORD and secure its prior authorization. LANDLORD shall be furnished with a copy of any permit issued for such storage.

Although it is not intended that TENANT shall be responsible for any decrease in value of the Premises due to the mere passing of time, or for ordinary wear and tear of surfaces and other structural members of the building, nevertheless TENANT shall: (i) replace, with like kind and quality, doors, windows; electrical, sanitary and plumbing, fixtures; building equipment and/or other facilities or fixtures in the Premises which through TENANT'S use, fault or negligence, become too worn out to repair during the life of this Lease, (ii) paint the property inside and outside as required.

In addition to the foregoing, TENANT shall indemnify and safe harmless LANDLORD from and against any and all cost, expenses, claims, losses, damages, or penalties, including counsel fees, because of or due to TENANT'S failure to comply with the foregoing, and TENANT shall not call upon LANDLORD for any disbursement or outlay of money whatsoever, and hereby expressly releases and discharges LANDLORD of and from any liability or responsibility whatsoever in connection therewith.

THIRTEEN: Roof Care - TENANT, without the prior consent of LANDLORD, shall not: (i) erect or cause to be erected on the roof any bill board, aerial sign, or structure of any kind, (ii) place any fixture, equipment or any other load over the roof, (iii) drill any hole on the roof for whichever purpose, (iv) use the roof for storage, nor (v) correct any leaks whatsoever, this being LANDLORD'S sole responsibility. Furthermore, TENANT shall take all reasonable precautions to insure that the drainage facilities of the roof are not clogged and are in good and operable conditions at all times.

FOURTEEN: Floor Loads - TENANT hereby acknowledges that it has been informed by LANDLORD that the maximum floor load of the Premises herein demised is 150 pounds per sq. ft. Therefore, TENANT hereby agrees that in the event the load of the machinery and equipment to be installed thereat exceeds such maximum load, it shall, at its own cost and expense, carry out any improvements to the floor of the Premises which may be necessary to support such additional load; it being further agreed and understood that construction and/or installation of such improvements shall not be commenced until after LANDLORD'S approval of the plans to be prepared therefor by TENANT and thereafter, after completion of construction and/or installation of said facilities, they shall be deemed covered by and subject to the applicable provisions of this Contract; it being further specifically agreed and understood that upon termination of this Lease, such facilities shall be removed by TENANT, at its own cost and expense, or in the alternative, and upon request by LANDLORD, they shall remain as part of the Premises with no right whatsoever on the part of TENANT to be reimbursed and/or compensated therefor.

FIFTEEN: Fixtures - TENANT shall not affix to the ceiling, nor to its supporting joists or columns, nor to any of its walls, any air conditioning unit, nor any other fixture, without the prior consent of LANDLORD.

SIXTEEN: Environmental Protection and Compliance - TENANT agrees, as a condition hereof, that it will not discharge its solid, liquid or gaseous industrial and/or sanitary effluent or discharges, either into the sewer system and/or into any other place until after required authorizations therefor has been obtained from the Puerto Rico Aqueduct and Sewer Authority, and/or the Department of Health of Puerto Rico and/or Environmental Quality Board, and/or any other governmental agency having jurisdiction thereof and TENANT further agrees and undertakes to pre-treat any such effluent, prior to discharge thereof as required by the said Authority, Department and/or governmental agency with jurisdiction, and/or to install any equipment or system required, and to fully abide by and comply with any and all requisites imposed thereby, and upon request by LANDLORD to submit evidence of such compliance; it being agreed that non-compliance thereof by TENANT for a period of ninety (90) days after notice, shall be deemed an additional event of default under the provisions hereof. Provided, that no construction and/or installation shall be made until LANDLORD has approved of it.

TENANT shall also, at TENANT'S own cost and expense, construct and maintain Premises, processes and/or operating procedures in compliance with the terms, conditions and commitments specified in any Environmental Impact Statement, Environmental Assessment or any other analogous document produced by the Commonwealth of Puerto Rico, Economic Development Administration/LANDLORD as lead agency/ or by any other governmental agency in connection with the approval or operation of the project.

TENANT shall also serve LANDLORD with a copy of any lawsuit, notice of violation, order to show cause or any other regulatory or illegal action against TENANT in any environmental-related case or issue.

TENANT shall also serve LANDLORD with a copy of any permit granted to TENANT for air emissions, water discharge, solid waste generation, storage, treatment and/or disposal, and for any hazardous and/ or toxic waste raw materials or by-products used or generated, stored, treated and/or disposed or any other endorsement, authorization or permit required to be obtained by TENANT.

TENANT shall also serve LANDLORD with a copy of any filing or notification to be filed by TENANT with any regulatory agency or any environmentally related case or issue, especially in any situation involving underground or surface water pollution, hazardous and/or toxic waste spillage and ground contamination. The notification to LANDLORD shall take place not later than the actual filing of the pertinent documents with the regulatory agency.

SEVENTEEN: Improper Use - TENANT, during the term of this Lease and of any renewal or extension thereof, agrees not to use or keep or allow the leased Premises or any portion thereof to be used or occupied for any unlawful purpose or in violation of this Lease or of any certificate of occupancy or certificate of compliance covering or affecting the use of the Premises or any portion thereof, and will not suffer any act to be done or any condition to exist on the Premises or any portion thereof, or any article to be brought thereon, which may be dangerous, unless safeguarded as required by law, or which may in law, constitute a nuisance, public or private, or which may made void or voidable any insurance then in force on the leased Premises.

EIGHTEEN: Government Regulations - TENANT agrees and undertakes to abide by and comply with any and all rules, regulations and requirements of the Planning Board of Puerto Rico, the Department of Health, the Environmental Quality Board, the Environmental Protection Agency (EPA), where applicable and/or of any other governmental agency, having jurisdiction thereon applicable to TENANT'S operations at the Premises and/or products to be manufactured thereat, and if requested by LANDLORD, TENANT shall submit evidence of such compliance; it being agreed and understood that noncompliance with any and all such rules, regulations and requisites shall be deemed an additional event of default under the provisions of this Contract, unless remedied within thirty (30) days after receipt of notice thereof.

Any and all improvements to the Premises required by any governmental agency, having jurisdiction thereon so as to carry TENANT'S operations in accordance with the regulations and requisites thereof, shall be at TENANT'S own cost and expense, except for any improvements that may be required as a result of any violation by LANDLORD that may exist at the effective date hereof other than violations caused by TENANT or TENANT'S agents.

TENANT further agrees and undertakes to install in the Premises, at its own costs and expense, such devices as may be necessary to prevent any hazard, which may be caused or created by its operations from affecting the environmental integrity of the landsite or causing any nuisance to adjacent TENANTS and/or the community in general; it being agreed and understood that creating or causing any such nuisance, shall be deemed an additional event of default under the provisions of this Contract.

TENANT further agrees and undertakes to abide by and comply with any and all rules, regulations and requisites of the Fire Department relative to the use and storage of raw materials, finished products and/or inflammable materials, and/or of any other governmental agency, having jurisdiction thereon applicable to TENANT'S operations at the Premises, and if requested by LANDLORD, TENANT shall submit evidence of such compliance; it being agreed and understood that noncompliance by TENANT with any of the aforementioned rules, regulations and requisites shall be deemed, in each of such cases, an additional event of default under the provisions of this Contract, unless remedied within thirty (30) days after receipt of notice thereof.

If as a consequence of the foregoing dispositions, TENANT need to make alterations to the Premises, the same shall be done subject to the dispositions of Article TEN hereof.

NINETEEN: Use Permit - TENANT agrees to abide by and comply with any and all conditions and requisites included in the Use Permit which may be issued by the Puerto Rico Permits and Regulations Administration (ARPE), and if requested by LANDLORD, shall submit evidence of such compliance; it being agreed and understood that noncompliance by TENANT with any and all such conditions and requisites and/or the cancellation of the said Use Permit shall, in each of such cases, be deemed an additional event of default under the provisions of this Contract.

TWENTY: Inspection - TENANT shall permit LANDLORD or LANDLORD'S agents to enter the Premises at all reasonable time for the purpose of inspecting the same, or of making repairs that TENANT has neglected or refused to make as required by the terms, covenants and conditions of this Lease, and also for the purpose of showing the Premises to persons wishing to purchase the same, and during the year next preceding the expiration of this Lease, shall permit inspection thereof by or on behalf of prospective TENANTS. If, at a reasonable time, admission to the Premises for the purposes aforesaid cannot be obtained, or if at any time an entry shall be deemed necessary for the inspection or protection of the property, or for making any repairs, whether for the benefit of TENANT or LANDLORD, LANDLORD'S agents or representatives may enter the Premises by force, or otherwise, without rendering LANDLORD, or LANDLORD'S agents or representative liable to any claim or cause of action or damage by reason thereof, and accomplish such purpose.

The provisions contained in this Article are not to be construed as an increase of LANDLORD'S obligations under this Lease; it being expressly agreed that the right and authority hereby reserved does not impose, nor does LANDLORD assume, by reason thereof, any responsibility or liability whatsoever for the repair, care of supervision of the Premises, or any building, equipment or appurtenance on the Premises.

TWENTY ONE: LANDLORD'S entry for repairs and alterations - LANDLORD reserves the right to make such repairs, changes alterations, additions or improvements in or to any portion of the building and the fixtures and equipment which are reputed part thereof as it may deem necessary or desirable and for the purpose of making the same, to use the street entrances, halls, stairs and elevators of the building provided that there be no unnecessary obstruction of TENANT'S right of entry to and peaceful enjoyment of the Premises, and TENANT shall make no claim for rent abatement compensation or damages against LANDLORD by reason of any inconvenience or annoyance arising therefrom.

TWENTY TWO: LANDLORD excused in certain instances - If, by reason of inability to obtain and utilized labor, materials or supplies, or by reason of circumstances directly or indirectly the result of any state of war, or of emergency duly proclaimed by the corresponding governmental authority, or by reason of any laws, rules orders, regulations or requirements of any governmental now or hereafter in force or by reason of strikes or riots, or by reason of accidents, in damage to or the making of repairs, replacements or improvements to the building or any of the equipment thereof, or by reason of any other cause reasonable beyond the control of LANDLORD, LANDLORD shall be unable to perform or shall be delayed in the performance of any covenant to supply any service, such non-performance or delay in performance shall not be ground to any claim against LANDLORD for damages or constitute a total or partial eviction,

constructive or otherwise. it being agreed and understood that the time for completion of any such construction, shall be extended for a period of time equal to the number of days of any such delay.

TWENTY THREE: Quiet Enjoyment - TENANT on paying the full rent and keeping and performing the conditions and covenants herein contained, shall and may peaceably and quietly enjoy the Premises for the term aforesaid, subject, however, to the terms of this Lease and to the mortgages hereinafter mentioned.

TWENTY FOUR: Leasehold Improvements - If leasehold improvements made by or for the benefit of TENANT in the Premises at his request or other personal property to TENANT are assessable or taxable and a tax liability is imposed to TENANT or LANDLORD, it is understood that it shall be the sole responsibility of TENANT to pay such taxes and in no event shall such taxes be the liability of or be transferable to LANDLORD. In the event that by operation of law, such taxes became a liability of LANDLORD, TENANT shall pay such taxes as they become due and payable and shall promptly reimburse LANDLORD for any payments or expenses incurred or disbursed by LANDLORD by reasons of any such assessment. Said amount shall be due and payable, as additional rent, with the next installment of rent. In the event that TENANT fails to make this payment when due, it shall be subject to the dispositions of Article THIRTY SEVEN hereof.

TWENTY FIVE: Stoppage of Operations - It is understood by the parties hereto that this Lease is made by LANDLORD in furtherance of the industrialization plans of the Commonwealth of Puerto Rico, and it is accordingly understood that TENANT will use all reasonable efforts while this Lease is in effect to maintain a manufacturing operation upon the Premises, but nothing contained in this paragraph shall be deemed to require TENANT to maintain such an operation otherwise than in accordance with sound principles of business management, or (without limiting the generality of the foregoing) to prevent TENANT from curtailing such operation or from shutting it down, whenever and as often as TENANT may, in the exercise of sound business judgment, deem such action advisable. However, TENANT shall give to LANDLORD notice of any necessary or convenient curtailment and/or shut-down, at least seven (7) days prior to the date fixed therefor except in cases of an emergency shut-down, in which case such notice shall be given at the earliest possible time. No curtailment of operations or shut-down in accordance with the provisions of this paragraph shall constitute a default under the provisions of this Contract which will enable LANDLORD to terminate it, unless such plants shall have been shut-down for a period of six (6) consecutive months. A shut-down on account of unforeseeable event or events which although foreseeable could not be prevented, shall not constitute a breach of this agreement. Nothing in his paragraph contained shall relieve TENANT from the payment of rent during the period of any shut-down or curtailments of operations.

TWENTY SIX: Assignment and Subletting - TENANT shall not assign this Lease nor let or sublet the Premised or any part thereof except to its parent company, to a wholly owned subsidiary, to an affiliate of TENANT, wholly owned by TENANT'S parent company or to a corporation to be organized by TENANT. In any of these cases, TENANT shall promptly notify LANDLORD of said assignment or subletting, it being agreed and understood that no such

assignment or subletting shall. (i) reduce or, in any way, affect the obligations of TENANT under this Lease, nor (ii), release TENANT from liability under this Lease.

TWENTY SEVEN: Successors in Interest - This Lease Contract and every provision thereof, shall bind and inure to the benefit of the legal representatives, successors and assigns on the parties. However, the term "LANDLORD", as used in this Contract, so far as any covenants or obligations on the part of LANDLORD under this Lease are concerned, shall be limited to mean and include only the owner or lessor, at the time in question, of the Premises, so that in the event hereafter of a transfer of the title to the Premises, whether any such transfer be voluntary or by operation of law or otherwise, the person, natural or juridical, by whom any such transfer is made, shall be and hereby is entirely freed and relieved of all personal liability as respects the performance of the covenants and obligations of LANDLORD under this Lease from and after the date of such transfer.

TWENTY EIGHT: No Representation by LANDLORD - LANDLORD, LANDLORD'S agents or employees, or the agents, executives or employees of the Economic Development Administration, have made no representations or promises with respect to the Premises except as herein expressly set forth and no rights, easements or licenses are acquired by TENANT by implication or otherwise except as expressly set forth in the provisions of this Contract. The taking possession of the Premises by TENANT, shall be conclusive evidence, as against TENANT, that TENANT accepts same "AS IS" and that said Premises, particularly the building which forms a part of the same, were in good and satisfactory conditions at the time such possession was so taken.

TWENTY NINE: Damages - LANDLORD shall not be responsible for any latent defect or change of conditions in the Premises resulting in damage to the same, or the property or person therein, except to the extent of LANDLORD'S gross negligence, and provided such claims or loss is not covered by insurances herein required from TENANT. TENANT shall promptly notify LANDLORD of any damage to or defects in the Premises, particularly in any part of the building's sanitary, electrical, air conditioning or other systems located in our passing through the Premises, and the damage or defective conditions, subject to the provisions of Article TWENTY ONE (21) hereof, shall be remedied by LANDLORD with reasonable diligence.

THIRTY: General Liability Insurance - TENANT shall indemnify, have harmless and defend LANDLORD and agents, servants and employees of LANDLORD against and from any and all liability, fines, suits, claims, demands, expenses, including attorneys' fees, and actions of any kind or nature arising by reason of injury to person or property including the loss of use resulting thereof or, violation of law occurring in the Premises occasioned in whole or in part by any negligent act or omission on the part of TENANT or an employee (whether or not acting within the scope of his employment) , servant, agent, licensee, visitor, assignor or undertenant of TENANT, or by any neglectful use or occupancy of the Promises or any breach, violation or non-performance of any covenant in this Lease on the part of TENANT to be observed or Performed.

Pursuant to the foregoing, TENANT shall, maintain during the term of this lease, at its own cost and expense, a Comprehensive General Liability Policy. Said policy shall: (i) be for a

combined single limit of no less than $500,000.00 per accident, (ii) hold LANDLORD harmless against any and all liability as hereinbefore stated, and (iii) the care, custody & control exclusion shall be deleted from this coverage. LANDLORD may require additional reasonable limits of public liability insurance and coverages, when changing circumstances so require.

THIRTY ONE: Property Insurance - TENANT recognizes that the rent provided for herein does not include any element to indemnify, repair, replace or make whole TENANT, his employees, servants, agents, licensees, visitors, assignees, or undertenant for any loss or damage to any property or injury to any person in the Premises.

Accordingly, during the term of this Lease, TENANT shall keep the building standing upon the Premises at the commencement of the term hereof or thereafter erected upon the Premises, including all equipment appurtenant to the Premises and all alterations, changes, additions and improvements, insured for the benefit of LANDLORD and TENANT, as their respective interest may appear, in an amount at least equal to the percentages stated below (as LANDLORD may from time to time determine) . The basis of the Property Insurance shall be Replacement Cost and the coverage an "All Risks" Property Insurance Policy. Coverages included All Risks Form:

1. Fire - "Building & Contents Form"

   (a) Building - 100% of insurable value exclusive of foundations

   (b) Contents - All equipment appurtenant to the Premises (State value of Policy)

2. Additional Coverages under the Fire Policy

   (a) Extended Coverage Endorsement - 100% of insurable value exclusive of foundations

   (b) Earthquake - 100% of insurable value including foundations

   (c) Vandalism and Malicious Mischief Endorsement

   (d) Improvements and Betterments - For all alterations, changes, additions and improvements

3. Landsite and Flood whenever applicable and/or necessary

4. Boiler and machinery (if any) - 100% of insurable value

5. Pollution Liability Policy - if necessary.

THIRTY TWO: Multifactory Building Specific Dispositions - In the event that the Premises constitute a section or sections of an industrial building and landsite in which other operations are conducted by other TENANTS: (i) the insurance coverage herein required, shall be acquired by LANDLORD for the whole of the industrial building and TENANT shall

reimburse LANDLORD, for its proportionate share in the total cost of said policies, (ii) if, because of anything done, caused or permitted to be done, permitted or omitted by TENANT, the premium rate for any kind of insurance affecting the Promises shall be increased, TENANT shall pay to LANDLORD the additional amount which LANDLORD may be thereby obligated to pay for such insurance, and if LANDLORD shall demand that TENANT remedy the condition which cause the increase in the insurance premiums rate, TENANT will remedy such conditions within five (5) days after such demand, and (iii) the insurance policies required in the preceding Articles THIRTY (30) & THIRTY ONE (3l) shall be endorsed to include a waiver of subrogation against TENANT. All amounts to be reimbursed by TENANT under this Article, shall be due and payable, as additional rent, with the next installment of rent. In the event that TENANT fails to make this payment, when due, it shall be subject to the dispositions of Article THIRTY SEVEN (37) hereof.

THIRTY THREE: Additional Dispositions about Insurance - All the Insurance policies herein required from TENANT, shall be taken in form and substance acceptable to LANDLORD with insurance companies duly authorized to do business in Puerto Rico, having a "A" and a higher financial fatting according to Best's Insurance Report; and shall include LANDLORD as additional insured. TENANT shall instruct the corresponding insurer to deliver such policies or certified copies of Certificates of Insurance, in lieu of, directly to LANDLORD. LANDLORD reserves the right not to deliver possession of the Premises to TENANT, unless, and until two (2) days after such original policies, or certified copies or certificates have been deposited with LANDLORD.

Furthermore, said policies, shall: (i) provide that they may not be cancelled by the insurer for nonpayment of premium or otherwise, until at least thirty (30) days after services of notice by registered or certified mail of the proposed cancellation upon LANDLORD, and (ii) be promptly renewed by TENANT upon expiration and TENANT shall, within thirty (30) days after such renewal, deliver to LANDLORD adequate evidence of the payment of premiums thereon. If such premiums or any of them shall not be so paid, LANDLORD may procure the same in the manner set forth for governmental agencies, and TENANT shall reimburse LANDLORD any amount so paid. This reimbursement being due and payable with the next installment of rent. In the event that TENANT fails to make this payment when due, it shall be subject to the dispositions of Article THIRTY SEVEN (37) hereof. It is expressly agreed and understood, that payment by LANDLORD of any such premiums shall not be deemed to waive or release the default in the payment thereof by TENANT nor the right of LANDLORD to take such action as may be available hereunder as in the case of default in the payment of rent.

Upon the commencement of the term hereof, TENANT shall pay to LANDLORD the apportioned unearned premiums on all such policies of insurance then carried by LANDLORD in respect of the Premises in the event TENANT continues with the insurance policies placed in LANDLORD.

TENANT shall not violate nor permit to be violated any of the conditions or provisions of any of said policies, and TENANT shall so perform and satisfy the requirements of the companies writing such policies that at all times companies of good standing and acceptable to LANDLORD shall be willing to write and continue such insurance.

TENANT shall cooperate with LANDLORD in connection with the collection of any insurance monies that may be due in the event of loss and shall execute and deliver to LANDLORD such proofs of loss and other instruments that may be required for the purpose of

facilitating the recovery of any such insurance monies, and in the event that TENANT shall fail or neglect so to cooperate or to execute, acknowledge and deliver any such instrument, LANDLORD, in addition to any other remedies, may as the agent or attorney-in fact of TENANT, execute and deliver any proof of loss or any other instruments as may seem desirable to LANDLORD and any mortgagee for the collection of such insurance monies. This shall not be interpreted as any waiver of the obligations of TENANT under Articles THIRTY, THIRTY ONE , THIRTY TWO and THIRTY THREE hereof or exclusively in favor of LANDLORD under Article THIRTY NINE hereof.

THIRTY FOUR: Waivers - The receipt by LANDLORD of the rent, additional rent, or any other sum or charges payable by TENANT with or without knowledge of the breach of any covenant of this Contract, shall not be deemed a waiver of such breach. No act or omission of LANDLORD or its agent during the term of this Lease shall be deemed an acceptance of a surrender of the Premises and to agreement to accept a surrender of the Premises shall be valid unless it be made in writing and subscribed by LANDLORD. This Contract contains all the agreements and conditions made between the parties hereto with respect to the Premises and it cannot be changed orally. Any additions to, or charges in this Lease must be in writing, signed by the party to be charged.

Failure on the part of LANDLORD to act or complain of any action or nonaction on the part of TENANT shall not be deemed to be a waiver of any of its respective rights hereunder nor constitute a waiver at any subsequent time of the same provision. The consent or approval by LANDLORD to, or of any action by the other requiring consent or approval, shall not be deemed to waive or render unnecessary the consent or approval by LANDLORD of any subsequent similar act.

THIRTY FIVE: Reinstatement - No receipt of monies by LANDLORD for TENANT after the termination or cancellation hereof in any lawful manner shall reinstate, continue or extend the term hereof, or affect any notice theretofore given to TENANT, or operate as a waiver of the right of LANDLORD to enforce the payment of rent, additional rent, or other charges then due or thereafter falling due, or operate as a waiver of the right of LANDLORD to recover possession of the Premises by proper suit, action, proceeding or remedy; it being agreed that, after the service of notice to terminate or cancel this Lease, and the expiration of the time therein specified, if the default has not been cured in the meantime, or after the commencement of suit, action or summary proceedings or of any other remedy, or after a final order, warrant of judgment of the possession of the Premises, LANDLORD may demand, receive and collect any monies then due, or thereafter becoming due, without in any manner affecting such notice, proceeding, suit, action, order,, warrant or judgment; and any and all such monies so collected shall be deemed to be payments for the use and occupation of the Premises, or at the election of LANDLORD, on account of TENANT'S liability hereunder. Delivery or acceptance of the keys to the Premises, or any similar act, by the LANDLORD, or its agents or employees, during the term hereof, shall not be deemed to be a delivery or an acceptance of a surrender of the Promises unless LANDLORD shall explicity consent to it, in the manner set forth hereinbefore.

THIRTY SIX: Subordination -and Attornment - This Lease is and shall be subject and subordinate to all liens, or mortgages which may now or hereafter affect the Premises and to all renewals, modifications, consolidations, replacements and extensions thereof and, although this

subordination provision shall be deemed for all purposes to be automatic and effective without any further instrument on the part of TENANT, TENANT shall execute any further instrument requested by LANDLORD to confirm such subordination.

TENANT further covenants and agrees that if by reason of a default upon the part of LANDLORD of any mortgage affecting the Premises, the mortgage is terminated or foreclosed by summary proceedings or otherwise, TENANT will attorn to the mortgagee or the purchaser in foreclosure proceedings, as the case may be, and will recognize such mortgage or purchaser, as the TENANT'S landlord under this Lease. TENANT agrees to execute and deliver, at any time and from time to time, upon the request of LANDLORD or of the mortgagee or the purchaser in foreclosure proceedings, as the case may be, any reasonable instrument which may be necessary or appropriate to evidence such attornment. TENANT further waives the provision of any statute or rule of law now or hereafter in effect which may give or purport to give TENANT any right of election to terminate this lease or to surrender possession of the Premises demised hereby in the event any such proceeding is brought by the holder of any such mortgage, and TENANT'S obligations hereunder shall not be affected in any way whatsoever by any such proceeding.

TENANT, covenants and agrees, upon demand of the holder of any mortgage duly recorded or recordable in the corresponding Registry of the Property or of any receiver duly appointed by the foreclose any such mortgage, to pay to the holder of any such mortgage or to such receiver, as the case may be, all rent becoming due under this Lease after such demand, provided such holder of any such mortgage or any such receiver complies with the obligations of LANDLORD under this Lease.

TENANT, upon request of LANDLORD or any holder of any mortgage or lien affecting the Premises, shall from time to time, deliver or cause to be delivered to LANDLORD or such lien holder or mortgagee, within ten (10) working days from date of demand a certificate duly executed and acknowledged in form for recording, without charges, certifying, if true, or to extent true, that this Lease is valid and subsisting and in full force and effect and LANDLORD is not in default under any of the terms of this Lease.

THIRTY SEVEN: Late Payments and Payment by LANDLORD - In the event that (i) TENANT makes late payment, or fails to make payments to LANDLORD, in whole or in part, of the rent, or of the additional rent, or of any of the other payments of money required to be paid by TENANT to LANDLORD, as stipulated in this Lease, when and as due and payable; of if (ii) LANDLORD, without assuming any obligation to do so, after any notice or grace period provided hereunder, performs or causes to be performed, at the cost and expense of TENANT, any of the acts or obligations agreed to be performed by TENANT, as stipulated in this Lease, and TENANT fails to refund LANDLORD any amounts of money paid or incurred by LANDLORD in performing of causing the performance of such acts or obligations, when and as due and payable, TENANT undertakes and agrees to pay LANDLORD as additional rent, interest on such lately paid or unpaid rents, additional rent, and/or on such other payments of money required to be paid, and/or such amounts of money required to be refunded, from and after the date when payment thereof matured or became due and payable, until full payment, at the rate of twelve (12%) per cent per annum, or if such 12% interest, is unlawful, then and in such event, at the highest maximum prevailing rate of interest on commercial unsecured loans as fixed by the board of Regulatory Rates of Interest and Financial Charges, created under Law #1, approved October 15, 1973 (10 LPRA 998), as amended, or by any successor statute or regulation thereof.

THIRTY EIGHT: Abatement - If any substantial service or facility to be provided by LANDLORD is unavailable for a period exceeding thirty (30) days and LANDLORD has been notified of the same, should time unavailability of such service render all or any portion of the Premises untenable, TENANT after the aforesaid thirty (30) days, shall be entitled to an abatement of a portion of the rent that shall reflect that portion of the Premises which is untenable, provided the damage to the service or facility is not attributable to the act or neglect of TENANT or the employees, servants, licensees, visitors, assigns or undertenants of TENANT.

THIRTY NINE: Fire or other Casualty - If before or during the term of this Lease, the Premises shall be damaged by fire or other casualty, LANDLORD after written notice thereof is given by TENANT, shall repair the same with reasonable dispatch after notice to it of the damage, due allowances being made for any delay due to causes beyond the LANDLORD'S reasonable control, provided, however, that LANDLORD shall not be required to repair or replace any furniture, furnishings or other personal property which TENANT may have placed or installed or which it may be entitled or required to remove from the Premises. LANDLORD shall proceed with due diligence to obtain the corresponding insurance adjustment of the loss and TENANT shall fully cooperate with LANDLORD and assist in the adjustment of the loss. Until such repairs are completed, and provided such damage or other casualty is not attributable to the act or neglect of TENANT or the employees, servants, licensees, visitors, assigns or undertenants of TENANT, the rent required to be paid pursuant to Article FOUR hereof, shall be abated in proportion to the part of the Premises which are untenable. If the building, be so damaged that LANDLORD shall decide to demolish and/or to reconstruct the building, in whole or in part, LANDLORD may terminate this Lease by notifying TENANT within a reasonable time after such damage of LANDLORD'S election to terminate this Lease, such termination to be effective immediately if the term shall not have commenced or on a date to be specified in such notice if given during the term. In the event of the giving of such notice during the term of this Lease, the rent shall be apportioned and paid up to the time of such fire or other casualty if the Premises are damaged, or up to the specified date of termination if the Premises are not damaged and LANDLORD shall not be otherwise liable to TENANT for the value of the unexpired term of this Lease.

FORTY: Default Provisions - If, during the term of this Lease, TENANT shall: (i) apply for or consent in writing to, the appointment of a receiver, trustee or liquidator of TENANT or of all or substantially all of its assets or (ii) seek relief under the Bankruptcy Act, or admit in writing its inability to pay its debts as they become due, or (iii) make a general assignment for the benefit of this creditors, or (iv) file a petition case or an answer seeking relief (other than a reorganization not involving the liabilities of TENANT) or arrangement with creditors, or take advantage of any insolvency law, or (v) file an answer admitting the material allegations of a case filed against it in any bankruptcy, reorganization or insolvency proceeding or, if an order, judgment or decree shall be entered by any court of competent jurisdiction on the application of TENANT or creditor adjudicating TENANT a bankrupt or insolvent, or approving a petition seeking reorganization of TENANT (other than a reorganization not involving the liabilities of TENANT) or appointment of a receiver, trustee or liquidator of TENANT, or of all or substantially all its assets, and such order, judgment or decree, shall continue stayed and in effect for any period of sixty (60) consecutive days, their term of this Lease and all right, title and interest of TENANT hereunder shall expire as fully and completely as if that day were the date

herein specifically fixed for the expiration of the term, and TENANT will then, quit and surrender the Premises to LANDLORD, but TENANT shall remain liable as hereinafter provided.

If, during the term of this Lease: (i) TENANT shall default in fulfilling any of the covenants of this Lease (other than the covenants for the payment of rent or additional rent), or of any other standing contract with LANDLORD or (ii) if, during the term of this Lease TENANT shall abandon, vacate, or remove from the Premises the major portion of the goods, wares, equipment, or furnishings usually kept on said premises, of (iii) this Lease, without the prior consent of LANDLORD, shall be encumbered, assigned or transferred in any manner in whole or in part or shall, by operation of law, pass to or devolve upon any third party, except as herein provided, or (iv) if TENANT is in violation of laws, rules and regulations regarding minimum wages of its employees, or of any other law, rules and regulations applicable to his operations, but which have not been specifically mentioned in this Lease, LANDLORD may give to TENANT notice of any such default or the happening of any event referred to above and if at the expiration of thirty (30) days after the service of such an notice the default or event upon which said notice was based shall continue to exist, or in the case of a default which cannot with due diligence be cured within a period of thirty (30) days, if TENANT fails to proceed promptly after the service of such notice and with all due diligence to cure the same and thereafter to prosecute the curing of such default with all due diligence (it being intended that in connection with a default not susceptible of being cured with due diligence within thirty (30) days that the time of TENANT within which to cure the same shall be extended for such period as may be necessary to complete the same with all due diligence), LANDLORD may give to TENANT a notice of expiration of the term of this Lease as of the date of the service of such second notice, and upon the giving of said notice of expiration the term of this Lease and all right, title and interest of TENANT hereunder shall expire as full and completely as if that day were the date herein specifically fixed for the expiration of the term, and TENANT or any party holding under his will then quit and surrender the Premises to LANDLORD, but TENANT shall remain liable as hereinafter provided.

If, (i) TENANT shall default in the payment of the rent, the additional rent, or of any other payment as required under this Lease and such default shall continue for ten (10) working days after notice thereof by LANDLORD, of (ii) if the default of the payment of the rent, continues for thirty (30) days from the date any such payment became due and payable (AUTOMATIC DEFAULT TERMINATION), or (iii) if this Lease shall terminate as in Paragraph one and two of this Article provided, this lease shall terminate and TENANT will then quit and surrender the Premises to LANDLORD, but TENANT shall remain liable as hereinafter provided, LANDLORD or LANDLORD'S agents and servants may immediately or at any time thereafter re-enter the Premises and remove all persons and all or any property therefrom, whether by summary dispossess proceedings or by any suitable action or proceeding at law, or with the license and permission of TENANT, which shall under this Contract be deemed given upon expiration of the strict thirty (30) days notice period of subdivision of paragraph Two of this Article, without LANDLORD being liable to indictment, prosecution or damages therefor and repossess and enjoy the Premises with all additions, alterations, and improvements.

If TENANT shall fail to take possession of the Premises within ten (10) days after the commencement of the term of this Lease, of if TENANT shall vacate and abandon the

Premises, LANDLORD shall have the right, at LANDLORD'S option, to terminate this Lease and the term hereof, as well as all the right, title and interest of TENANT hereunder, by giving TENANT five (5) days notice in writing of such intention, and upon the expiration of the time fixed in such latter notice, if such default be not cured prior thereto, this lease and the term hereof, as well as all the right, title and interest of TENANT hereunder, shall wholly cease and expire in the same manner and with the same force and effect (except as to TENANT'S liability) as if the date fixed by such latter notice were the expiration of the term herein originally granted; and TENANT shall immediately quit and surrender to LANDLORD the Premises and each and every part thereof and LANDLORD may enter into or repossess the Premises, either by force, summary proceedings or otherwise. The right granted to LANDLORD in this Article or any other Article of this Lease to terminate this Lease, shall apply to any extension or renewal of the term hereby granted, and the exercise of any such right by LANDLORD during the term hereby granted, shall terminate any extension or renewal of the term hereby granted and any right on the part of TENANT thereto.

Upon the termination of this Lease by reason of any of the foregoing event, or in the event of the termination of this Lease by summary dispossess proceedings or under any provisions of law, nor or at any time hereafter, in force by reason of, or based upon, or arising out of a default under or breach of this Lease on the part of TENANT, or upon LANDLORD recovering possession of the Premises in the manner or in any of the circumstances hereinbefore mentioned, or in any other manner or circumstances whatsoever, whether with or without legal proceedings, by reason of, or based upon, or arising out of a default under or breach of this Lease on the part of TENANT, LANDLORD, at its option, but without assuming any obligation to do so in any case, may at any time, and from time to time, relet the Premises or any part or parts thereof for the account of TENANT or otherwise on such terms as LANDLORD may elect, including the granting of concessions, and receive and collect the rents therefor, applying the same at a rental not higher than the one stipulated in this Contract, first to the payment of such reasonable expenses as LANDLORD may have incurred in recovering possession of the Premises, including reasonable legal expenses, and for putting the same into good order or condition or preparing or altering the same for re-rental, and expenses, commissions and charges paid, assumed, or incurred by LANDLORD in and about the reletting of the Premises or any portion thereof and then to the fulfillment of the covenants of TENANT hereunder. Any such reletting herein provided for, may be for the remainder of the term of this Lease or for a longer or shorter period or at a higher or lower rental. In any such case, whether or not, the Premises or any part thereof be relet, TENANT shall pay to LANDLORD the rent required to be paid by TENANT up to the time of such termination for this Lease, and/or the full rent provided for in the agreement for any holdover of such period after termination and up to the surrender or recovery of possession of the Premises by LANDLORD, as the case may be, and thereafter TENANT covenants and agrees, to pay to LANDLORD until the end of the term of this Lease as originally demised the equivalent of any deficiency amount of all the rent reserved herein, less the net avails of reletting, if any, as specified hereinabove in this Article and the same shall be due and payable by TENANT to LANDLORD as provided herein, that is to say, TENANT shall pay to LANDLORD the amount of any deficiency then existing.

FORTY ONE: LANDLORD'S Remedies - In the event TENANT shall default in the performance of any of the terms, covenants or provisions herein contained, LANDLORD

may , but without the obligation to do so, perform the same for the account of TENANT and any amount paid or expense incurred by LANDLORD in the performance of the same shall be repaid by TENANT on demand. In the event of a breach or threatened breach by TENANT or any subtenant or other person holding or claiming under TENANT of any of the covenants, conditions or provisions hereof, LANDLORD shall have the right of injunction to restrain the same, and the right to invoke any remedy allowed by law or in equity as if specific remedies, indemnity or reimbursement were not herein provided for. The rights and remedies given to LANDLORD in this Lease are distinct, separate and cumulative, and no one of them, whether or not exercised by LANDLORD, shall be deemed to be a waiver, or an exclusion of any of the others.

FORTY TWO: Notice of Default - Anything in this Lease to the contrary notwithstanding, it is specifically agreed that there shall be no enforceable default against LANDLORD under any provision of this Lease, unless notice of such default be given by TENANT to LANDLORD in which TENANT shall specify the default or omission complained of, and LANDLORD shall have thirty (30) days after receipt of such notice in which to remedy such default, or if said default or omission shall be of such a nature that the same cannot be cured within said period, then the same shall not be an enforceable default if LANDLORD shall have commenced taking the necessary steps to cure or remedy said default within the said thirty (30) days and diligently proceeds with the correction thereof.

FORTY THREE: Capitalization - For the purpose of this Contract, specifically of Article SIX, Capitalization includes the total of owner's equity sources (preferred stock, common stock and surplus accounts)plus long-term debts, it being agreed and understood that the amortization of any such debt shall in no way diminish the amount originally determined as capitalization.

FORTY FOUR: Disclosure of Information - TENANT agrees to furnish to LANDLORD within ninety (90) days after the expiration of each fiscal year of TENANT, an annual statement certified by an independent Certified Public Accountant showing as of the end of each such fiscal year: (i) TENANT'S paid-in capital, (ii) long-term debts and capitalization as required by Articles SIX and FORTY THREE hereof, (iii) investment in machinery and its capacity to provided employment, (iv) taxes (including Social Security taxes) paid, and (v) any other information as required by this Lease.

In the event such statement is not field with LANDLORD as herein provided, LANDLORD may obtain such information from TENANT at TENANT'S expense, and for such purpose TENANT shall make available to LANDLORD'S designated representatives, its books of accounts and other necessary data and facilities, all of which shall be provided and made available at TENANT'S principal office in Puerto Rico.

FORTY FIVE: Automatic Renewal - In the event TENANT does not vacate the Premises in the manner and under the conditions hereinbefore provided, within ninety (90) days after the normal expiration of the term hereof, LANDLORD shall have the option to be exercised at any time thereafter, to notify TENANT that the lease herein has been renewed for an additional term of ten (10) years from the date of the last normal expiration of the term hereof and, in such

event, the parties agree that this Contract shall be held to have been renewed and to continue in full force and effect for such additional term of ten (10) years upon the mere mailing of such notice by LANDLORD to TENANT. This provision shall in no way prejudice, affect or deny any right which LANDLORD may otherwise have because, or at the time, of any such termination of the term hereof, particularly whenever LANDLORD does not exercise such option; it being agreed and understood that such renewal shall be upon the same terms and conditions contained herein except that the rental rate to be charged shall be the rate then currently being charged by LANDLORD for similar building in the area, but in no event shall it be less than the rate herein stipulated.

FORTY SIX: Partial Invalidity and Applicable Law - If any term or provisions of this Lease or the application thereof to any person or circumstances shall, to any extent, be invalid or unenforceable, the remainder of this Lease and the application of such term or provision to persons or circumstances other than those as to which it is held invalid or unenforceable, shall not be affected thereby, and each term and provision of this Lease shall be valid and be enforceable to the fullest extent permitted by law. This Contract is entered into and shall be interpreted in accordance with the laws of the Commonwealth of Puerto Rico.

FORTY SEVEN: Lease Termination and Holding Over - Upon the expiration or termination of this Lease:

(i) TENANT shall inform LANDLORD in writing of TENANT'S activities affecting each or any environmental area of concern during the period of TENANT'S operation, including a description from an environmental standpoint of the physical conditions of the premises and landsite. TENANT shall also inform to LANDLORD in writing of any environmental regulatory violations, compliance plans, permits, closure plans, cleanup actions or any other regulatory procedures related to the operation. In the event that the information reveals TENANT'S noncompliance of any of the above, or in the event that a physical inspection of the Premises and adjacent areas by LANDLORD, or any other source of information reveal the possibility of contamination, in that event, TENANT shall, at LANDLORD'S request submit a plan of action with the appropriate financial provisions to execute it. LANDLORD shall hold TENANT responsible for any and all environmental damage, or any damage to third parties as a result of any environmental damage, or any remedial action (including monitoring) to be performed at landsite or otherwise as a result of TENANT'S operations after termination of Lease and until such a time as complete remediation or fulfillment of TENANT'S obligations is effected. In case TENANT fails to comply with the foregoing provisions, LANDLORD may elect to effect them at TENANT'S expense and responsibility.

(ii) TENANT shall remove all hazardous and toxic substances belonging to TENANT or to a third party. TENANT shall also remove all other property of TENANT and that of any third party and failing so to do, TENANT hereby appoints LANDLORD its agent so that LANDLORD may cause all of the said property to be removed at the expense and risk of TENANT. TENANT covenants and agrees to give full and timely observance and compliance to this covenant to remove all its property and surrender the Premises broom clean. TENANT hereby agrees to pay all reasonable necessary cost and expenses thereby incurred by LANDLORD. If, as the sole result of the removal of TENANT'S property any portion of the

Additional Premises or of the building of which they are a part, are damaged, TENANT shall pay to LANDLORD the reasonable cost of repairing such damages unless due to the gross negligence of LANDLORD, its agents, servants, employees and contractors. TENANT'S obligation to observe or perform this covenant shall survive the expiration or other termination of the term of this Lease.

FORTY EIGHT: Change of Address - TENANT shall promptly notify LANDLORD of any change it the addresses other than those required from it in Article SEVEN hereof.

FORTY NINE: TENANT will indemnify LANDLORD for any and all liability, loss, damages, expenses, penalties and/or fines, and any additional expenses including any attorney fees LANDLORD may suffer as a result of claims, lawsuits, demands, administrative orders, costs, resolutions or judgements against it arising out of negligence and/or failure of TENANT or those acting under TENANT to conform to the statutes, ordinances, or other regulations or requirements of any governmental authority, be it Federal, of the Commonwealth of Puerto Rico, its instrumentalities or public corporations, in connection with the performance of this Lease.

FIFTY: Anything contained in this Contract to the contrary notwithstanding, in the event that TENANT requires additional volume of water and/or pressure as is now available within the area wherein the demised premises are located, it shall be at its own cost and expense the construction and/or installation of such improvements and/or facilities as may be necessary to or convenient and/or required by the Puerto Rico Aqueduct and Sewer Authority to increase such volume and/or pressure; it being agreed and understood, however, that such construction and/or installation shall in no event be commenced until after LANDLORD'S written approval has first been requested and obtained.

FIFTY-ONE: TENANT hereby acknowledges that in the industrial park there are other industries; therefore TENANT hereby specifically agrees and undertakes to take such steps and install such equipment as may be necessary to prevent that any hazard and/or noise which may be created by its operations may in any way or manner unduly affect the operations of the other industries and therefore TENANT hereby releases and saves LANDLORD harmless from any and all claims or demands arising therefrom or in connection therewith.

FIFTY-TWO: TENANT shall, at its own cost and expense, install a fire protection system and shall obtain the endorsement and approval from said Fire Department for such installation. TENANT must also provide security measures to prevent or reduce fire hazard due to the storage of inflammable materials and products.

FIFTY-THREE: TENANT shall procure and obtain a permit for the operation of a solid waste emission source from the Environmental Quality Board and authorization for the Office of Solid Waste and/or from the Municipality of Anasco for the final disposition of wastes.

FIFTY-FOUR: TENANT, at its own cost and expense, shall implement the necessary measures and install the control equipment to maintain the atmospheric air quality levels in compliance with the environmental laws and regulations of the Environmental Quality

Board and the Environmental Protection Agency, as promulgated by any succeeding law or regulations.

FIFTY-FIVE: It is hereby agreed and understood that TENANT shall take the necessary steps to comply with the regulations and law requirements of the PUERTO RICO OCCUPATIONAL SAFETY AND HEALTH OFFICE (PROSHO).

FIFTY-SIX: TENANT shall, at its own cost and expense, construct and/or install all necessary equipment required to connect the building's electrical system to the Puerto Rico Electrical Power Authority's electrical distribution lines, such connection to be made in compliance with the requirement of PREPA.

FIFTY-SEVEN: TENANT must comply with the rules and regulations of pre-treatment established by the Puerto Rico Aqueduct and Sewer Authority, the Environmental Quality Board and the Environmental Protection Agency related to the effluent industrial discharge in the sanitary sewer system and their final disposition. Also, any improvement necessary to provide pre-treatment facilities for the above mentioned effluents shall be at TENANT'S own cost and expense and in coordination and with the approval of LANDLORD'S Engineering and Maintenance Departments.

FIFTY-EIGHT: It is hereby agreed and understood that TENANT, at its own cost and expense, shall install an air conditioning system in the demised premises, in the event TENANT needs to use and/or install it in his process. Such air conditioning system shall be considered as a special facility from LANDLORD, and it shall be installed in coordination with LANDLORD'S Engineering and Maintenance Departments.

FIFTY-NINE: TENANT shall obtain a permit from the Public Service Commission to situate the propage gas and diesel tank. The installation of said tank shall be in coordination with LANDLORD'S (MAINTENANCE OR ENGINEERING) Department.

SIXTY: Inasmuch as TENANT represented that in order to carry out its operations it is necessary to install and operate a emergency generator; it is hereby specifically agreed and understood that:

(1) Such installation shall be made in coordination and with the approval of LANDLORD;

(2) TENANT shall request and obtain from the Environmental Quality Board,, the necessary permit to operate the said installation and, thereafter, shall abide by and comply with all requisites imposed by the said Board for such operations.

It being further agreed and understood that non-compliance by TENANT with the foregoing provisions shall constitute an additional event of default under the provisions of this Contract.

SIXTY-ONE: If applicable, TENANT also, shall at its own cost and expense, obtain the endorsement and approval from the FEDERAL DRUG AND FOOD ADMINISTRATION concerning the salubrity aspects to be implanted in its operations.

SIXTY-TWO: Anything contained in this Contract to the contrary notwithstanding, if required by TENANT, it shall be at TENANT'S own cost and expense the construction and/or installation of a sprinkler system; it being agreed and understood that such construction shall be accordance with the provisions hereof.

SIXTY-THREE: LANDLORD agrees to indemnify and save harmless TENANT, TENANT'S successors and assigns and TENANT's present and future officers, directors, employees and agents (collectively "Indemnitees") from and against any and all liabilities, penalties, fines, forfeitures, demands, damages, losses, claims, causes of action, suits, judgments, and costs and expenses incidental thereto (including cost of defense, Settlement, reasonable attorney's fees, reasonable consultant's fees and reasonable expert fees), which TENANT or any or all of the indemnitees may hereafter suffer, incur, be responsible for or disburse as a result of:

1. any governmental action, order, directive, administrative proceeding or ruling;
2. personal or bodily injuries (including death) or damage (including loss of use) to any premises (public or private);
3. cleanup, remediation, investigation or monitoring of any pollution or contamination of or adverse effects on human health or the environment; or
4. any violation or alleged violation of laws, statutes, ordinances, orders, rules or regulations of any governmental entity or agency

(collectively "Environmental Liabilities") directly or indirectly caused by or arising out of any Environmental Hazards existing on or about the premises except to the extent that any such existence is caused by TENANT'S activities on the premises. The term "Environmental Hazardous" shall be defined as hazardous substances, hazardous wastes, pollutants, asbestos, polycholinated biphenyls (PCBs), petroleum or other fuels (including crude oil or any faction or derivative thereof) and underground storage tanks. The term "hazardous substances" shall be as defined in the Comprehensive Environmental Response, Compensation, and Liability Act (42 U.S.C. Section 9601 et sq.) (CERCLA), and any regulations promulgated pursuant thereto. The term "hazardous wastes" shall be as defined in the Resource Conservation and Recovery Act (42 U.S.C. Section 6901 et seq.) (RCRA), and any regulations promulgated pursuant thereto. The term "pollutants" shall be as defined in the Clean Water Act (33 U.S.C. Section 1251 et seq.), and any regulations promulgated pursuant thereto. This provision shall survive termination of the lease.

TENANT agrees to indemnify and save harmless LANDLORD, LANDLORD's successors and assigns and LANDLORD'S present and future officers, directors, employees and agents (collectively "Indemnities") from and against any and all liabilities, penalties, fines, forfeitures, demands, damages, losses, claims, causes of action, suits, judgments, and costs and expenses incidental thereto (including cost of defense, settlement, reasonable attorney's fees, reasonable consultant fees and reasonable expert fees), which LANDLORD or any or all of the Indemnities may hereafter suffer, incur, be responsible for or disburse as a result of any Environmental Liabilities directly or indirectly caused by or arising out of any Environmental Hazardous existing on or about the premises but only to the extent that any such existence is caused by TENANT'S activities on the premises. This provision shall survive termination of the Lease.

In the event any Environmental Hazards are found at any time to be in existence or about the premises other than any Environmental Hazards whose existence is caused by TENANT'S activities on the premises, TENANT shall have the right to terminate this Lease by so notifying

LANDLORD in writing. Notwithstanding anything to the contrary contained herein, TENANT shall not be required to pay for any environmental Liability as operating expenses, additional rental or otherwise if TENANT is not responsible for such expenses pursuant to this paragraph.

SIXTY-FOUR: LANDLORD hereby leases to TENANT in its present condition and during the term of this lease Lot Number 6 (L-154-2-62-06-00). Such Lot shall be used by TENANT exclusively for parking purposes. Also, it is agreed that TENANT shall provide and/or construct at its own cost and expense such improvements as may deem necessary to operate said parking. However, TENANT shall not use said lot for profit purposes, sublet the same, nor permit the use of same or part of same to any public or private entity without the previous written consent of LANDLORD with the exception of LANDLORD's authorization to sublease part of said Lot to Baxter Healthcare Corp., established in Lot Number 5, for parking facilities for Baxter's employees. It is also agreed that TENANT shall always maintain, provide and keep in force the necessary insurance coverage required by LANDLORD's Insurance Department during the term of the lease.

SIXTY-FIVE: In is hereby agreed and understood that any special facilities property of LANDLORD, installed on the demises, shall be included, as part of the Contract by Supplenent and Amendment to Lease, once Landlord's Conservation and Engineering Offices make the necessary inspection and inventory of said facilities in coordination with TENANT.

SIXTY-SIX: This Contract may be resolved by LANDLORD previous notification to TENANT after the first sixty (60) days of the term of this Lease, if TENANT does not obtain a favorable recommendation or endorsement of the lease and or use of the premises from the Puerto Rico Environmental Quality Board, the Puerto Rico Aqueduct and Sewer Authority (PRASA) and LANDLORD's Planning and Environmental Offices. LANDLORD's undertaking under this terms and conditions in no event is to be considered as a precedent or as creating a custom of leasing its properties under such conditions.

SIXTY-SEVEN: TENANT certifies and guarantees that at the date of subscribing this Contract it does not have any tax debt pending with the Commonwealth of Puerto Rico.

TENANT also certifies and guarantees that at the date of execution of this contract it has paid unemployment insurance compensation, temporary disability insurance, and the driver's social security (as applicable); or is complying with a payment plan duly approved.

TENANT acknowledges that this is an essential condition of the Contract and if the above certification is incorrect in any of its parts, LANDLORD may cancel this contract.

SIXTY-EIGHT: LANDLORD reserves the right to audit the leased premises from time to time during the term of this contract, as LANDLORD may deem necessary, in order to assess all aspects of the environmental condition of said premises and TENANT'S compliance with all environmental legislation and regulations, under Commonwealth and federal law; TENANT hereby agrees to provide access to all areas and structures of the promises for these purposes, upon LANDLORD's request, and to also provide access to all books, records, documents and instruments which LANDLORD may deem necessary in order to fully audit the premises as herein stated.

SIXTY-NINE: TENANT shall furnish to LANDLORD, in addition to any other information, documents or instruments that may be required in this contract:

a) Prompt written notice of the occurrence of any event that by law or regulation would require any oral, telephonic or written notice or communication to the US Environmental Protection Agency and/or to the Puerto Rico Environmental Quality Board, or any successor agency, and copies of all orders, notices or other communications and reports received, made or given in connection with any such event, and any enforcement action taken against TENANT or against any property owned, occupied or used by TENANT;

b) Annually certifications subscribed by an authorized representative designated by TENANT, as to the environmental condition of the leased premises, containing the information required by LANDLORD, which is specified in the form included as schedule "B" of this contract, or any subsequent modification thereto;

c) Any other information and documents relating to TENANT'S compliance with environmental legislation and regulations under federal and commonwealth laws.

SIXTY-NINE: TENANT hereby guarantees to LANDLORD that, neither he, or any of its stockholders, in case of a corporation, owes any money to LANDLORD under its corporate name or any other corporate name and/or person.

SEVENTY: TENANT shall not transfer, lease, burden or dispose of in any way of the equipment used on its operations without the previous written notice of LANDLORD, except in the ordinary course of business and provided that TENANT is not on default.

SEVENTY-ONE: TENANT agrees to submit to LANDLORD within thirty (30) days from the date of execution of this Contract: (a) evidence of its registration in the Department of State of the Commonwealth of Puerto Rico and the name and address of its resident agent; and (b) a certificate of a resolution of its Board of Directors either authorizing or ratifying the execution of this Contract.

IN WITNESS WHEREOF, LANDLORD and TENANT have respectively signed upon proper authority this Lease, this 30th day of June , 1994.

PUERTO RICO INDUSTRIAL DEVELOPMENT COMPANY
SSP-66-0292871

BY: [signed]
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HEYER-SCHULTE NEUROCARE, INC.
SSP-36-3951590

BY: [signed]
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SCHEDULE "A"

DESCRIPTION OF LANDSITE AND BUILDING
LOCATED AT ANASCO, PUERTO RICO
(L-154-3-69-07-0)
SITE FOR PROJECT NO. T-08100-68

LANDSITE:

Parcel of land located at Anasco Industrial Park in the municipality of Anasco, Puerto Rico with a surface area of 4,395.49 square meters, equivalent to 1.1183 "cuerdas".

It bounds: by the NORTH, with land owned by Francisco Lugo Lugo and Milton Guzman Garcia; by the SOUTH, with a park street; by the EAST; with State Road No. 402; and by the WEST, with lot No. 9 of the same industrial park.

ENCUMBRANCES:

It is affected by a 5.0 ft. wide right of way in favor of P.R.E.P.A. running along its western boundary.

BUILDING NO. T-0810-0-68:

The building is a pitched roof type consisting of reinforced concrete foundations, steel columns and steel girders supporting 30 feet long steel joists which in turn support gage #22 standard galvanized steel deck covered by 1" fiberglass insulation and a 3 ply built-up roof.

The structure consists of a main floor 120'-11" x 90'-6" out to out dimensions with an area of 10,943.26 sq. ft. of manufacturing space; one lean-to 30'-8" x 10'-6" for an area of 322.04 sq. ft. for sanitary facilities and a loading platform 16'-0" x 10'-0" for an area of 160.00 sq. ft. All amounts to a total area of 11,425.30 sq. ft. of covered floor space.

The floor consists of a 3 1/2" thick reinforced concrete slab with a monolithic cement finish designed for a live load of 150 p.s.f.

Exterior walls are of concrete block plastered and painted, a 6'-1" sprayed-on glazed finish is provided as wainscoat.

Windows are aluminum miami louvers throughout the building.

Clearance in the manufacturing area from finished floor to lowest part of beams at the side eaves is 12'-2".

DESCRIPTION OF LOT NO. 6
PUBLIC USE LOT L-154-2-62-06-0
LOCATED AT ANASCO INDUSTRIAL PARK
ANASCO, PUERTO RICO
- ---------------------------------

LANDSITE:

Parcel of land lot No. 6 (public use lot) located at Anasco, Puerto Rico.

It bounds: by the NORTH, with access street of the same industrial park; by the SOUTH, with land owned by Sunc. Arraras; by the EAST; with State Road No. 402; and by the WEST, with lot No. 8 of the same industrial park,

It has a surface area of 2518.707 square meters, equivalent to 0.6408 cuerdas.

ENCUMBRANCES:

It is affected by a 5.0 ft. wide right of way in favor of P.R.E.P.A. running along its western boundary.

SCHEDULE "B"

COMPLIANCE REPORT OF WITH
ENVIRONMENTAL REQUIREMENTS

In the period of ___________ to ___________

I. PERMITS

| PERMITS NUMBER | EXPIRATION DATE | RENEWAL DATE (IF APPLY) |
| --- | --- | --- |

II. COMPLIANCE ACTIONS

| REFERENCE/CASE NUMBER | DATE | RESPONSE OF DATE OF |
| --- | --- | --- |

III. CERTIFICATION

I certify, under penalty of law, that this document was prepared under my supervision and direction; and that was based in my investigation by the persons directly responsible of gathering the information, that the information here submitted is, according to my best judgment, certain, complete and precise.

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SORRENTOVIEW
Industrial Real Estate Triple Net Sublease

(Lease Extension)

# ARTICLE I
# BASIC TERMS

This Article One contains the Basic Terms of this Sublease between the Landlord and Tenant named below. This Sublease is subject to the Master Lease identified in Section 2.1 below. Other Articles, Sections and Subsections of the Sublease referred to in this Article One explain and define the Basic Terms and are to be read in conjunction with the Basic Terms.

1.1 DATE OF SUBLEASE. April 1, 1993

1.2 LANDLORD. GAP Portfolio Partners, a New York general partnership.

Address of Landlord: c/o Richardson Partners, Inc., 10211 Pacific Mesa Blvd., Suite 4067, San Diego, CA 92121.

1.3 TENANT. Camino Laboratories, a Delaware corporation.
Address of Tenant: 5955 Pacific Center Blvd., San Diego, CA 92121

1.4 PREMISES. In consideration of the rents, covenants and agreement on the part of the Tenant to be paid and performed, the Landlord subleases to the Tenant, and Tenant subleases from Landlord those certain Premises identified on Exhibit "A" attached hereto and by this reference incorporated herein. The Premises contain approximately 19,897 square feet of space, and are situated within that certain building ("Building") known as Building 6 (Entire Building) and located at 5955 Pacific Center Blvd., San Diego, CA 92121. The Building is situated within that certain project ("Project") known as SORRENTOVIEW, located at the eastside of Pacific Mesa Boulevard, between Pacific Mesa Court and Pacific Center Boulevard, San Diego, California, more particularly identified on Exhibit "B" attached hereto and by this reference incorporated herein.

1.5 SUBLEASE TERM. Fifty-one (51) Months, beginning on April 1, 1993 or such date as is specified in this Sublease, and ending on June 30, 1997 (See Article Two).

1.6 PERMITTED USES. The Premises shall be used and occupied only for general office, and medical equipment laboratory, assembly, and warehousing purposes. (See Section 5.1).

1.7 TENANT'S GUARANTOR. (If none, so state.) None.

1.8 INITIAL SECURITY DEPOSIT. (See Section 3.3) Thirteen thousand one hundred nine dollars ($13,109.00)

1.9 RENT AND OTHER CHARGES PAYABLE BY TENANT.

1.9.1 BASE RENT. Thirteen thousand one hundred nine dollars ($13,109.00) per month for the first twelve (12) months, as provided, in Section 3.1, and shall be increased on each annual anniversary of the Commencement Date, beginning one (1) year after the Commencement Date, by three percent (3%) of the Base Rent in effect during the immediately preceding one year period.

1.9.2 OTHER PERIODIC PAYMENTS: ADDITIONAL RENT. (i) Real Property Taxes; (ii) Utilities; (iii) Insurance Premiums; (iv) Common Area Charges; (v) Impounds for Insurance Premiums and Property Taxes; (vi) Maintenance, Repairs and Alterations (See Articles Four and Six). See Additional Provision Sublease Rider.

1.10 RIDERS. The following Riders are attached to and made a part of this Sublease. (If none, so state.)

1. Additional Provisions
2. Tenant Improvement
3. Option to Extend

# ARTICLE II
# SUBLEASE TERM

2.1 MASTER LEASE. Landlord is the ground lessee of the real property improved with and identified as the Project under that certain Lease dated August 25, 1987, by and between the San Diego Unified School District ("District") as lessor and Landlord as lessee (the "Master Lease"). The Master Lease provides that Landlord may construct improvements and sublease portions thereof to tenants. Accordingly, and subject to the Master Lease, Landlord is entering into this sublease with Tenant.

2.2 SUBLEASE OF PREMISES FOR SUBLEASE TERM. Landlord subleases the Premises to Tenant and Tenant subleases the Premises from Landlord for the Sublease Term. The Sublease Term is for the period stated in Section 1.5 above and shall begin and end on the dates specified in Section 1.5 above, unless the beginning or end of the Sublease Term is changed under any provision of this Sublease. The "Commencement Date" shall be the date specified in Section 1.5 above for the beginning of the Sublease Term, unless advanced or delayed under any provision of this Sublease.

2.3 DELAY IN COMMENCEMENT. Landlord shall not be liable to Tenant if Landlord does not deliver possession of the Premises to Tenant on the first date specified in Section 1.5 above. Landlord's non-delivery of the Premises to Tenant on that date shall not affect this Sublease or the obligations of Tenant under this Sublease. However, the Commencement Date shall be delayed until

possession of the Premises is delivered to Tenant. The Sublease Term shall be extended for a period equal to the delay in delivery of possession of the Premises to Tenant, plus the number of days necessary to end the Sublease Term on the last day of a month. If Landlord does not deliver possession of the Premises to Tenant within ninety (90) days after

the first date specified in Section 1.5 above, Tenant may elect to cancel this Sublease by giving written notice to Landlord within ten (10) days after the 90-day period ends. If Tenant gives such notice, the Sublease shall be cancelled and neither Landlord nor Tenant shall have any further obligations to the other. If Tenant does not give such notice, Tenant's right to cancel the Sublease shall expire and the Sublease Term shall commence upon the delivery of possession of the Premises to Tenant. If delivery of possession of the Premises to Tenant is delayed, Landlord and Tenant shall, upon such delivery, execute an amendment to this Sublease setting forth the Commencement Date and expiration date of the Sublease. For purposes of this Section 2.3, Landlord's delivery of possession of the Premises shall mean the earlier of (i) the date Tenant occupies all or any portion of the Premises, or (ii) the date upon which the Premises are substantially complete in accordance with Exhibit A.

2.4 EARLY OCCUPANCY. If Tenant occupies the Premises prior to the Commencement Date, Tenant's occupancy of the Premises shall be subject to all of the provisions of this Sublease. Early occupancy of the Premises shall not advance the expiration date of this Sublease. Tenant shall pay Base Rent and all other charges specified in this Sublease for the early occupancy period.

2.5 HOLDING OVER. Tenant shall vacate the Premises upon the expiration or earlier termination of this Sublease. Tenant shall reimburse Landlord for and indemnify Landlord against all damages incurred by Landlord from any delay by Tenant in vacating the Premises. If Tenant remains in possession of all or any part of the Premises after the expiration of the term hereof, with or without the express or implied consent of Landlord, such tenancy shall be from month-to-month only and not a renewal hereof or an extension for any further term, and in such case, Base Rent then in effect shall be increased by twenty-five percent (25%) and other monetary sums due hereunder shall be payable in the amount and at the time specified in this Sublease; and such month-to-month tenancy shall be subject to every other term, covenant and agreement contained herein, except that the month-to-month tenancy will be terminable on thirty (30) days notice given at any time by either party.

2.6 SURRENDER OF PREMISES. Upon the termination of the Sublease, Tenant shall surrender the Premises to Landlord in the condition specified in and according to Section 6.7.

## Article III
## BASE RENT

3.1 TIME AND MANNER OF PAYMENT. Upon execution of this Sublease, Tenant shall pay Landlord the Base Rent in the amount stated in Subsection 1.9.1 above for the first month of the Sublease Term. On the first day of the second month of the Sublease Term and each month thereafter, Tenant shall pay Landlord the Base Rent in United States currency, in advance, without offset, deduction or prior demand. The Base Rent shall be payable at Landlord's address or at such other place as Landlord may designate in writing.

3.2 INCREASE. The Base Rent shall be increased at the times specified in Subsection 1.9.1 above. Tenant shall be obligated to pay the new Base Rent from its effective date until the next periodic increase without any prior notice from Landlord.

3.3 SECURITY DEPOSIT INCREASES.

3.3.1 DEPOSIT. Upon the execution of this Sublease, Tenant shall deposit with Landlord a cash Security Deposit in the amount set forth in Section 1.8 above. Landlord may apply all or part of the Security Deposit to any unpaid rent or other charges due from Tenant or to cure any other defaults of Tenant. If Landlord uses any part of the Security Deposit, Tenant shall restore the Security Deposit to its full amount within ten (10) days after Landlord's written request. Tenant's failure to do so shall be a material default under this Sublease. No interest shall be paid on the Security Deposit. Landlord shall not be required to keep the Security Deposit separate from its other accounts and no trust relationship is created with respect to the Security Deposit.

3.4 TERMINATION; ADVANCE PAYMENTS. Upon termination of this Sublease under Article Seven (Damage or Destruction), Article Eight (Condemnation), or any other termination not resulting from Tenant's default, and after Tenant has vacated the Premises in the manner required by this Sublease, an equitable adjustment shall be made concerning advance rent, any other advance payments made by Tenant to Landlord, and accrued real property taxes, and Landlord shall refund the unused portion of the Security Deposit to Tenant or Tenant's successor.

Article IV

OTHER CHARGES PAYABLE BY TENANT

4.1 ADDITIONAL RENT. All charges payable by Tenant other than Base Rent are called "Additional Rent." Unless this Sublease provides otherwise, all Additional Rent shall be paid with the next monthly installment of Base Rent and shall be in United States currency. The term "rent" shall mean Base Rent and Additional Rent.

4.2 REAL PROPERTY TAXES.

4.2.1 PAYMENT OF TAXES. Tenant shall pay its proportionate share of all real property taxes and general and special assessments, levied and assessed against the Project of which the Premises are a part. Tenant's proportionate share of real property taxes shall be the ratio that the total number of square feet in the Premises bears to the total number of sub-leasable square feet in the Project. Each year Landlord shall notify Tenant of Landlord's calculation of Tenant's proportionate share of the real property taxes and together with such notice shall furnish Tenant with a copy of the tax bill. If any supplemental tax bills are delivered with respect to the Project, Landlord may notify Tenant of Landlord's new calculation of Tenant's proportionate share of real property taxes as soon as such supplemental tax bill is received. Subject to Section 4.8 below, Tenant shall reimburse Landlord for Tenant's proportionate share of the Real Property Taxes semiannually no later than fifteen (15) days before the taxing authority's delinquency date.

4.2.2 DEFINITION OF "REAL PROPERTY TAX." "Real Property Tax" means: (i) any fee, license fee, license tax, commercial rental tax, levy, charge, assessment, penalty or tax (other than inheritance or estate taxes) imposed by any authority having the direct or indirect power to tax, including any City, County, State or Federal government, or any school, agriculture, lighting, drainage or other improvement district thereof, as against any legal or

equitable interest of Landlord in the Premises; (ii) any tax on the Landlord's right to receive, or the receipt of, rent or income from the Premises or against Landlord's business of leasing the Premises; (iii) any tax or charge for fire protection, streets, sidewalks, road maintenance, refuse or other services provided to the Premises by any governmental agency; (iv) any tax imposed upon this transaction or based upon a reassessment of the Premises due to a change in ownership or transfer of all or part of Landlord's interest in the Premises; and (v) any charge or fee replacing any tax previously included within the definition of Real Property Tax. "Real Property Tax" does not, however, include Landlord's Federal or State income, franchise, inheritance or estate taxes.

4.2.3 JOINT ASSESSMENT. If the Premises is not separately assessed, Tenant's share of the Real Property Tax payable by Tenant under Subsection 4.2.1 shall be determined from reasonably available information. Landlord shall make a reasonable determination of Tenant's proportionate share of such real property tax and Tenant shall pay such share to Landlord within fifteen (15) days after receipt of Landlord's written statement.

4.2.4 PERSONAL PROPERTY TAXES.

(a) Tenant shall pay prior to delinquency all taxes charged against trade fixtures, furnishings, equipment or any other personal property belonging to Tenant. Tenant shall attempt to have such personal property taxed separately from the Premises.

(b) If any such taxes on Tenant's personal property are levied against Landlord or Landlord's Premises, or if the assessed value of the Premises is increased by the inclusion therein of a value placed upon such personal property or trade fixtures of Tenant, then Landlord, after written notice to Tenant, shall have the right to pay the taxes based upon such increased assessments, regardless of the validity thereof, but only under proper protest if requested by Tenant in writing. If Landlord shall do so, then Tenant shall, upon demand, repay to Landlord the taxes levied against Landlord, or the proportion of such taxes resulting from such increase in the assessment. In any such event, however, Tenant, at Tenant's sole cost and expense, shall have the right, in the name of Landlord and with Landlord's full cooperation, to bring suit in any court of competent jurisdiction to recover the amount of any such taxes so paid under protest; any amount so recovered to belong to Tenant.

(c) If any of Tenant's personal property is taxed with the Premises, Tenant shall pay Landlord the taxes for the personal property within fifteen (15) days after Tenant receives a written statement from Landlord for such personal property taxes.

4.2.5 TENANT'S RIGHT TO CONTEST TAXES. Tenant may attempt to have the assessed valuation of the Premises reduced or may initiate proceedings to contest the Real Property Tax. If required by law, Landlord shall join in the proceedings brought by Tenant. However, Tenant shall pay all costs of the proceedings, including any costs or fees incurred by Landlord. Upon the final determination of any proceeding or contest, Tenant shall immediately pay the excess Real Property Tax due, together with all costs, charges, interest and penalties incidental to the proceedings. If Tenant does not pay the excess Real Property Tax when due when due and contests such taxes, Tenant shall not be in default under this Sublease for nonpayment of such taxes if Tenant deposits funds with Landlord or opens an interest bearing

account reasonably acceptable to Landlord in the joint names of Landlord and Tenant. The amount of such deposit shall be sufficient to pay the excess Real Property Tax plus a reasonable estimate of the interest, costs, charges and penalties which may accrue if Tenant's action is unsuccessful, less any applicable tax impounds previously paid by Tenant to Landlord. The deposit shall be applied to the excess Real Property Tax due, as determined at such proceedings. The excess Real Property Tax shall be paid under protest from such deposit if such payment under protest is necessary to prevent the Premises from being sold under a "tax sale" or similar enforcement proceeding.

4.3 UTILITIES. Tenant shall arrange for and pay, directly to the appropriate supplier, the cost of all natural gas, heat, light, power, sewer, telephone, water and other utilities and services supplied to the Premises. Landlord will cooperate in attempting to have each of the utilities supplied to the Premises separately metered. However, if any such utilities or services are jointly metered with other premises within the Project, Landlord shall make a reasonable determination of Tenant's proportionate share of the cost of such utilities and services, based on information reasonably available to Landlord, and Tenant shall pay such share to Landlord within fifteen (15) days after receipt of Landlord's written statement of such cost.

4.4 INSURANCE PREMIUMS.

4.4.1 LIABILITY INSURANCE. During the Sublease Term, Landlord shall maintain a policy of comprehensive public liability insurance at Tenant's expense, insuring Landlord against liability arising out of the ownership, use, occupancy or maintenance of the Premises. The initial amount of such insurance shall be at least $5,000,000.00, and shall be subject to periodic increase based upon inflation, increased liability awards, recommendations of professional insurance advisers, and other relevant factors. However, the amount of such insurance shall not limit Tenant's liability nor relieve Tenant of any obligation hereunder. The policy shall contain cross-liability endorsements, if applicable, and shall insure Tenant's performance of the indemnity provisions of Section 5.4. Tenant shall, at Tenant's expense, maintain such other liability insurance as Tenant deems necessary to protect Tenant.

4.4.2 HAZARD AND RENTAL INCOME INSURANCE. During the Sublease Term, Landlord shall, at Tenant's expense, maintain policies of insurance covering loss of or damage to the Premises to the extent of at least one hundred percent (100%) of its replacement value. Such policies shall provide protection against all perils included within the classification of fire, extended coverage, vandalism, malicious mischief, and any other perils which Landlord deems necessary. Landlord may obtain insurance coverage for Tenant's fixtures, equipment or building improvements installed by Tenant in or on the Premises. Tenant shall, at Tenant's expense, maintain such primary or additional insurance on its fixtures, equipment and building improvements as Tenant deems necessary to protect its interest. During the Sublease Term, Landlord may also maintain a rental income insurance policy at Tenant's expense, with loss payable to Landlord in an amount equal to one year's Base Rent (as adjusted periodically), estimated Real Property Taxes and insurance premiums. Tenant shall not do or permit to be done anything which invalidates any such insurance policies.

4.4.3 PAYMENT OF PREMIUMS; INSURANCE POLICIES. Tenant shall pay its pro rata share of the premiums for maintaining the insurance required by Subsections 4.4.1 and

4.4.2. Tenant's pro rata share of all such premiums shall be based on the same proportion as used for payment of taxes pursuant to Subsection 4.2.1 hereof. All such amounts will be due and payable upon ten (10) days written notice.

4.4.4 INCREASE IN FIRE INSURANCE PREMIUM. Tenant agrees that it will not keep, use, manufacture, assemble, sell or offer for sale in or upon the Premises any article which may be prohibited by the standard form of fire insurance policy. Tenant agrees to pay any increase in premiums for fire and extended coverage insurance that may be charged during the term of this Sublease on the amount of such insurance which may be carried by Landlord on said Premises or the building of which it is a part, resulting from the acts or omissions of the Tenant, its agents, servants or employees, or the use or occupancy of the Premises by the Tenant or from the type of materials or products stored, manufactured, assembled or sold by Tenant in the Premises, whether or not Landlord has consented to the same. In determining whether increased premiums are the result of Tenant's use of the Premises, a schedule, issued by the organization making the insurance rate on the Premises, showing the various components of such rate, shall be conclusive evidence of the several items and charges which make up the fire insurance rate on the Premises.

4.4.5 WAIVER OF SUBROGATION. Landlord and Tenant each hereby waive any and all rights of recovery against the other or against the officers, employees, agents and representatives of the other, on account of loss or damage occasioned to such waiving party or its property or the property of others under its control, to the extent that such loss or damage is insured against under any fire and extended coverage insurance policy which either may have in force at the time of such loss or damage. Tenant shall, upon the policies of insurance required under this Sublease, give notice to the insurance carrier or carriers that the foregoing mutual waiver of subrogation is contained in this Sublease.

4.5 COMMON AREAS.

4.5.1 DEFINITION; LOCATION. As used in this Sublease, "Common Areas" shall mean all areas within the Project which are available for the common use of tenants of the Project and which are not leased or held for the exclusive use of tenants of the Project or which are not leased or held for the exclusive use of Tenant or other tenants, including, but not limited to, parking areas, driveways, sidewalks, loading areas, retaining walls, truck serviceways, pedestrian malls, stairs, ramps, restrooms, access roads, corridors, landscaping and planted areas. Landlord may from time to time change the size, location, nature and use of the Common Areas, including converting Common Areas into leasable areas, construction of additional parking facilities (including parking structures) in the Common Areas, and increasing or decreasing Common Area land and/or facilities. Tenant acknowledges that such activities may result in occasional inconvenience to Tenant from time to time. Such activities and changes shall be expressly permitted if they do not materially affect Tenant's use of the Premises.

4.5.2 USE OF COMMON AREAS. Subject to other provisions of this Sublease, Tenant shall have the nonexclusive right (in common with other tenants and all others to whom Landlord has granted or may grant such rights) to use the Common Areas for the purposes intended, subject to such reasonable rules and regulations as Landlord may establish from time to time. Tenant shall abide by such rules and regulations and shall use its best effort to cause others

who use the Common Areas with Tenant's expressed or implied permission to abide by Landlord's rules and regulations. At any time, Landlord may close any Common Areas to perform any acts in and to the Common Areas as, in Landlord's judgment, may be desirable to improve the Project. Tenant shall not, at any time, intentionally interfere with the rights of Landlord, other tenants, or any other person entitled to use the Common Areas.

4.5.3 VEHICLE PARKING. Tenant shall be entitled to use 3.8 vehicle parking spaces in the Project for each 1,000 (One Thousand) square feet within the Premises without paying any additional rent. Tenant's parking shall not be reserved and shall be limited to vehicles no larger than standard size automobiles or pickup utility vehicles. Tenant shall not cause large trucks or other large vehicles to be parked within the Project or on the adjacent public streets. Vehicles shall be parked only in striped parking spaces and not in driveways, loading areas or other locations not specifically designated for parking. If Tenant parks more vehicles in the parking area than the number identified herein, such conduct shall be a material breach of the Sublease.

4.5.4 MAINTENANCE OF COMMON AREAS. Landlord shall maintain the Common Areas in good order, condition and repair and shall operate the Project, in Landlord's sole discretion, as a first class industrial/commercial real property development. Tenant shall pay Tenant's pro rata share (as defined below) of all costs incurred by Landlord for the operation and maintenance of the Common Area. Common Area costs include, but are not limited to, costs and expenses for the following: gardening and landscaping; pest extermination services; utilities, water and sewage charges; maintenance of signs (other than Tenant's signs); premiums for liability, property damage, fire and other types of casualty insurance on the Common Areas and all Common Area improvements; all personal properly taxes levied on or attributable to personal property used in connection with the Common Areas; straight-line depreciation on personal property owned by Landlord which is consumed in the operation or maintenance of the Common Areas; rental or lease payments paid by Landlord for rented or leased personal property used in the operation or maintenance of the Common Areas; the reasonable rental value of any Common Area located within any building situated within the Project; fees for management of the Project and Common Areas; fees for required licenses and permits; repairing, resurfacing, repaving, maintaining , painting, lighting, cleaning, refuse removal, security and similar items; reserves; and a reasonable allowance to Landlord for Landlord's supervision of the Common Areas (not to exceed five percent (5%) of the total of all other Common Area costs for the calendar year). Landlord may cause any or all of such services to be provided by third parties, or by entities associated with Landlord. Common Area costs shall not include depreciation of real property which forms part of the Common Areas. Landlord may, at Landlord's election, estimate in advance and charge to Tenant monthly as Common Area costs, all real property taxes for which Tenant is liable under the Sublease, all insurance premiums for which Tenant is liable under the Sublease, and all maintenance and repair costs for which Tenant is liable under the Sublease.

4.5.5 TENANT'S SHARE AND PAYMENT. Tenant shall pay Tenant's annual pro rata share of all estimated Common Area costs, in advance, in monthly installments on the first day of each month during the Sublease Term (prorated for any fractional month). Tenant's pro rata share shall be calculated by dividing the square foot area of the Premises, as set forth in Section 1.4 of the Sublease, by the aggregate square foot area of the leaseable area within the

Project, whether currently leased or not upon the date the computation is made. Landlord may adjust such estimates at any time and from time to time based upon Landlord's experience and reasonable anticipation of costs. Such adjustments shall be effective as of the next rent payment date after notice to Tenant. Within thirty (30) days after the end of each calendar year of the Sublease Term, Landlord shall deliver to Tenant a statement prepared in accordance with generally accepted accounting principles setting forth, in reasonable detail, the actual Common Area costs paid or incurred by Landlord during the preceding calendar year and Tenant's pro rata share. Upon receipt of such statement, there shall be an adjustment between Landlord and Tenant with payment to or credit given by Landlord (as the case may be) so that Landlord shall receive the entire amount of Tenant's share of such costs and expenses for such period. Any changes in the Common Area costs and/or the aggregate area leased or held for lease for the exclusive use of all tenants of the Project during the Lease Term shall be effective on the first day of the month after such change occurs.

4.5.5.1 ALTERNATIVE PAYMENT. Notwithstanding the foregoing, Landlord has the right to notify Tenant on a monthly or other basis of the actual amount Landlord has expended for all Common Area costs incurred during the previous month or period. Such notice shall also set forth Tenant's pro rata share of such actual costs. Upon receipt of such statement, Tenant shall pay with the next monthly installment of rent Tenant's pro rata share of the actual Common Area costs incurred during the previous month or period.

4.5.6 ADDITIONAL AREAS. In addition to the Common Areas and costs associated therewith described in this Section 4.5, Landlord may, but is not obligated to, provide certain additional spaces and areas within the Project ("Additional Areas") as (and included within the definition of) Common Areas. The Additional Areas may include, but are not limited to, an office used by and subject to the exclusive control of Landlord for leasing and/or managing the Project, a conference room available on a reserved basis for use by tenants within the Project during normal business hours, and a locker room facility for use by tenants of the Project and their employees that are employed at the Project. Common Area costs for which Tenant is liable for its pro rata share as described in Section 4.5.4 shall include costs of operating and the reasonable rental value of the space occupied by the Additional Areas.

4.6 LATE CHARGES. Tenant's failure to pay rent promptly may cause Landlord to incur unanticipated costs. The exact amount of such costs is impractical or extremely difficult to ascertain. Such costs may include, but are not limited to, processing and accounting charges and late charges which may be imposed on Landlord by any ground sublease, mortgage or trust deed encumbering the Premises. Therefore, if Landlord does not receive any rent payment within five (5) days after it becomes due, Tenant shall pay Landlord a late charge equal to five percent (5%) of the overdue amount. The parties agree that such late charge represents a fair and reasonable estimate of the costs Landlord will incur by reason of such late payment.

4.6.1 REPEATED LATE CHARGES. In the event that a late charge is payable under this Sublease whether or not collected, for two installments of Base Rent during any one calendar year of the Sublease Term, then the Base Rent shall automatically become due and payable quarterly in advance, rather than monthly. All monies paid to Landlord under this provision may be commingled with other monies of Landlord and shall not bear interest.

4.7 INTEREST ON PAST DUE OBLIGATIONS. Any amount owed by Tenant to Landlord which is not paid when due shall bear interest at the rate of ten percent (10%) per annum or at the highest rate then permitted by law, whichever is less, from the due date of such amount. However, interest shall not be payable on late charges to be paid by Tenant under this Sublease. The payment of interest of such amounts shall not excuse or cure any default by Tenant under this Sublease. If the interest rate specified in this Sublease is higher than the rate permitted by law, the interest rate is hereby decreased to the maximum legal interest rate permitted by law.

4.8 IMPOUNDS FOR INSURANCE PREMIUMS AND REAL PROPERTY TAXES. If requested by any ground lessor or lender to whom Landlord has granted a security interest in the Premises or the Project if Landlord deems it necessary in Landlord's sole and absolute discretion, or if Tenant is more than ten (10) days late in the payment of rent more than once in any consecutive twelve (12) month period, Tenant shall pay Landlord a sum equal to one-twelfth (1/12) of the annual Real Property Tax and/or insurance premiums payable by Tenant under this Sublease, together with each payment of Base Rent. Such payment shall be paid to the ground lessor or lender if required or held by Landlord in an impound account with no obligation to pay the Tenant interest thereon. The amount of the Real Property Tax and insurance premiums when unknown shall be reasonably estimated by Landlord. Funds in the impound account shall be applied by Landlord to the payment of real property taxes and insurance premiums when due. Any deficiency of funds in the impound account shall be paid by Tenant to Landlord up on written request. If Tenant defaults under this Sublease, Landlord may apply any funds in the impound account to any obligation then due under this Sublease.

## ARTICLE V
## USE OF PREMISES

5.1 PERMITTED USES. Tenant may use the Premises only for the Permitted Uses set forth in Section 1.6 above.

5.2 MANNER OF USE.

5.2.1 OBJECTIONABLE USES. Tenant shall not do or permit anything to be done in or about the Premises which will in any way obstruct or interfere with or infringe on the rights of other occupants of the building, or injure or annoy them, or use or allow the Premises to be used for any improper, immoral, or objectionable purposes; nor shall Tenant cause, maintain or permit any nuisance in, on or about the Premises or commit or suffer to be committed any waste in, on or about the Premises. Tenant shall not be liable to Landlord for any other occupant's failure to so conduct itself.

5.2.2 NONPERMITTED USES. Tenant shall not do or permit to be done in or about the Premises nor bring, keep or permit to be brought or kept therein, anything which is prohibited by or will in any way conflict with any law, statute, ordinance or governmental rule or regulation now in force or which may hereafter be enacted or promulgated, or which is prohibited by any standard form of fire insurance policy or will in any way increase the existing rate of or affect any fire or other insurance upon the building or any part thereof or any of its contents, or cause a

cancellation of any insurance policy covering the building or any part thereof or any of its contents. Tenant shall comply with all governmental laws, ordinances and regulations applicable to the Premises, and the requirements of any Board of Fire Underwriters or other similar body now or hereafter instituted, with any order, directive or certificate of occupancy issued pursuant to any law, ordinance or regulation by any public officer insofar as the same relates to or affects the condition, use or occupancy of the Premises, including but not limited to, requirements of structural changes related to or affected by Tenant's acts, occupancy or use of the Premises, all at Tenant's sole expense. The judgment of any court of competent jurisdiction or the admission of Tenant in any action against Landlord, whether or not Tenant is a party to such action, shall be conclusive in establishing such violations between Landlord and Tenant.

5.2.3 NOXIOUS ODORS. Tenant shall not use, keep or permit to be used or kept any foul or noxious gas or substance in the Premises, or permit or suffer the Premises to be occupied or used in a manner offensive or objectionable to the Landlord or other occupants of the building by reason of noise, odors and/or vibrations, or interfere in any way with other Tenants or those having business therein, nor shall any animals or birds be brought in or kept in or about the Premises or the building. Tenant shall not conduct any auction on the Premises. No cooking shall be done or permitted by any Tenant on the Premises, nor shall the Premises be used for the storage of merchandise, for washing clothes, for lodging, or for any improper, objectionable or immoral purposes. Tenant shall not use or keep in the Premises or the building any kerosene, gasoline or inflammable or combustible fluid or material, or use any method of heating or air conditioning other than supplied by Landlord.

5.2.4 PERMIT. Tenant shall obtain and pay for all permits required for Tenant's occupancy of the Premises and shall promptly take all actions necessary to comply with all applicable statutes, ordinances, rules, regulations, orders and requirements regulating the use by Tenant of the Premises, including the Occupational Health and Safety Act.

5.3 SIGNS AND AUCTIONS.

5.3.1 AUCTION. Tenant shall not conduct, or permit to be conducted, any sale by auction on the Premises.

5.3.2 PROHIBITED SIGNS. Tenant shall not place, or suffer to be placed or maintained, on any exterior door, wall or window of the Premises any sign, awning or canopy, or advertising matter or other thing of any kind, and will not place or maintain any decoration, lettering or advertising matter on the glass of any window or door, or that can be seen through the glass, of the Premises without Landlord's prior written approval. Tenant further agrees to maintain such sign, awning, canopy, decoration, lettering, advertising matter or thing as may be approved, in good condition and repair at all times.

5.3.3 SIGN CRITERIA. Landlord not required to install any sign for Tenant.

5.4 HAZARDOUS MATERIALS.

5.4.1 PROHIBITION OF STORAGE. Tenant shall not cause or permit any Hazardous Material (as hereinafter defined) to be brought upon, kept or used in or about the

Premises or the Project by Tenant, its agents, employees, contractors or invitees, other than those expressly permitted by Landlord and identified below. If Tenant breaches the obligation stated in the preceding sentence, or if the presence of Hazardous Materials on the Premises caused or permitted by Tenant (including Hazardous Materials specifically permitted and identified below) results in contamination of the Premises, or if contamination of the Premises by Hazardous Material otherwise occurs for which Tenant is legally liable to Landlord for damage resulting therefrom, then Tenant shall indemnify, defend and hold Landlord, its agents and contractors harmless from any and all claims, judgments, damages, penalties, fines, costs, liabilities, or losses (including without limitation diminution in value of the Premises or any portion of the Project, damages for the loss or restriction on use of rentable or usable space or of any amenity of the Premises or Project, damages arising from any adverse impact on marketing of space in the Premises or the Project, and sums paid in settlement of claims, attorneys' fees, consultant fees and expert fees) which arise during or after the Sublease Term as a result of such contamination. This indemnification of Landlord by Tenant includes, without limitation, costs incurred in connection with any investigation of site conditions or any cleanup, remedial, removal, or restoration work required by any federal, state or local governmental agency or political subdivision because of Hazardous Material present in the soil or ground water on or under the Premises. Without limiting the foregoing, if the presence of any Hazardous Material on the Premises caused or permitted by Tenant results in any contamination of the Premises, Tenant shall promptly take all actions at its sole expense as are necessary to return the Premises to the condition existing prior to the introduction of any such Hazardous Material to the Premises, provided that Landlord's approval of such action shall first be obtained, which approval shall not be unreasonably withheld so long as such actions would not potentially have any material adverse long-term or short-term effect on the Premises or the Project.

5.4.2 TERMINATION OF LEASE. Notwithstanding the provisions of Paragraph 5.4.1 above, if (i) any anticipated use of the Premises by Tenant or any proposed assignee or sublessee of Tenant involves generation, storage, use, treatment or disposal of Hazardous Material, (ii) Tenant or the proposed assignee or sublessee has been required by any prior landlord, lender or governmental authority to take remedial action in connection with Hazardous Material contaminating a property if the contamination resulted from such party's action or use of the property in question, or (iii) Tenant or the proposed assignee or sublessee is subject to an enforcement order issued by any governmental authority in connection with the use, disposal or storage of a Hazardous Material, Landlord shall have the right to terminate the Lease in Landlord's sole and absolute discretion (with respect to any such matter involving Tenant) and it shall not be unreasonable for Landlord to withhold its consent to any proposed assignment or subletting (with respect to any such matter involving a proposed assignee or sublessee).

5.4.3 TESTING. At any time prior to the expiration of the Sublease Term, Landlord shall have the right to conduct appropriate tests of water and soil and to deliver to Tenant the results of such tests to demonstrate that contamination in excess of permissible levels has occurred as a result of Tenant's use of the Premises. Tenant shall further be solely responsible for and shall defend, indemnify and hold the Landlord, its agents and contractors harmless from and against all claims, costs and liabilities including actual attorneys' fees and costs, arising of or in connection with any removal, clean up, restoration and materials required hereunder to return

the Premises and any other property of whatever nature to their condition existing prior to the appearance of the Hazardous Materials.

5.4.4 UNDERGROUND TANKS. If underground or other storage tanks storing Hazardous Materials are located on the Premises or are hereafter placed on the Premises by any party, Tenant shall monitor the storage tanks, maintain appropriate records, implement reporting procedures, properly close any underground storage tanks, and take or cause to be taken all other steps necessary or required under the California Administrative Code, Title 23, Chapter 3, Subchapter 16, "Underground Storage Tank Regulations," and Division 20, Chapter 6.7 of the California Health & Safety Code "Underground Storage of Hazardous Substances," as they now exist or may hereafter be adopted or amended.

5.4.5 TENANT'S OBLIGATIONS. Tenant's obligations under this Paragraph 5.4 shall survive the termination of the Sublease. During any period of time employed by Tenant after the Termination of this Sublease to complete the removal from the Premises of any such Hazardous Materials, Lessee shall continue to pay the full rental in accordance with this Sublease, which rental shall be prorated daily.

5.4.6 DEFINITION OF "HAZARDOUS MATERIAL." As used herein, the term "Hazardous Material" means any hazardous or toxic substance, material or waste which is or becomes regulated by any local governmental authority, the State of California or the United States Government. The term "Hazardous Material" includes, without limitation, any material or substance which is (i) defined as a "hazardous waste," "extremely hazardous waste" or "restricted hazardous waste" under Sections 25115, 25117, 25122.7, or listed pursuant to Section 25140, of the California Health and Safety Code, Division 20, Chapter 6.5 (Hazardous Waste Control Law), (ii) defined as a "hazardous substance" under Section 25316 of the California Health and Safety Code, Division 2, Chapter 6.8 (Carpenter-Presly-Tanner Hazardous Substance Account Act), (iii) defined as a "hazardous material," "hazardous substance" or "hazardous waste" under Section 25501 of the California Health and Safety Code, Division 20, Chapter 6.95 (Hazardous Substances) (v) petroleum, (vi) asbestos, (vii) listed under Article 9 and defined as hazardous or extremely hazardous pursuant to Article 11 of Title 22 of the California Administrative Code, Division 4, Chapter 20, (viii) designated as a "hazardous substance" pursuant to Section 311 of the Federal Water Pollution Control Act (33 U.S.C. Section 1317), (ix) defined as a "hazardous waste'" pursuant to Section 1004 of the Federal Resource Conservation and Recovery Act, 42 U.S.C. Section 6901 et. seq. (42 U.S.C. Section 6903), or (x) defined as a "hazardous substance" pursuant to Section 101 of the Comprehensive Environmental Response Compensation and Liability Act, 42 U.S.C. Section 9601 et. seq. (42 U.S.C. Section 9601).

5.5 INDEMNIFICATION OF LANDLORD. Tenant shall indemnify Landlord and save it harmless from and against any and all claims, actions, damages, liability and expense in connection with loss of life , personal injury and/or damage to property arising from or out of any occurrence in, upon or about the Premises, or the occupancy or use by Tenant of the Premises or any part thereof, or occasioned wholly or in part by any act of omission of Tenant, its agents, contractors, employees, servants, tenants or concessionaires. Tenant shall further indemnify and hold Landlord harmless from and against any and all claims arising from any breach or default in performance of any obligation on Tenant's part to be performed under the terms of this Sublease,

or arising from any act, neglect, fault or omission of Tenant or its agents, contractors, employees, servants, tenants or concessionaires, and from and against all costs, attorneys' fees, expenses and liabilities incurred in connection with such claim or any action or proceeding brought thereon. In case any action or proceeding shall be brought against Landlord by reason of any such claim, Tenant upon notice from Landlord shall defend the same at Tenant's expense by counsel approved in writing by Landlord. Tenant, as a material part of the consideration to Landlord hereby assumes all risk of damage to property or injury to persons in, upon or about the Premises from any cause whatsoever except (i) that which is caused by the failure of Landlord to observe any of the terms and conditions of this Sublease where such failure has persisted for an unreasonable period of time after written notice of such failure, and (ii) Landlord's gross negligence or intentional misconduct. Tenant hereby waives all its claims in respect thereof against Landlord.

5.6 LANDLORD'S ACCESS. Landlord or its agents may enter the Premises at all reasonable times to show the Premises to potential buyers, investors or tenants or other parties, or for any other purpose Landlord deems necessary. Landlord shall give Tenant prior notice of such entry, except in the case of an emergency. Landlord shall give Tenant prior notice of such entry, except in the case of an emergency. Landlord may place customary "For Sale" or "For Sublease" signs on the Premises.

5.7 QUIET POSSESSION. See "Quiet Possession and Nondisturbance" clause in the Additional Provisions Sublease Rider.

5.8 WINDOW COVERING. Landlord shall select and install a standard window covering for use throughout the Project, including all windows in the Premises.

## ARTICLE VI
## CONDITION OF PREMISES;
## MAINTENANCE, REPAIRS AND ALTERATIONS

6.1 EXISTING CONDITIONS. Tenant accepts the Premises in its condition as of the execution of the Sublease, subject to any other provisions of this Sublease and to all recorded maters, laws, ordinances, and governmental regulations and orders. Tenant acknowledge that neither Landlord nor any agent of Landlord has made any representation as to the condition of the Premises or the suitability of the Premises for Tenant's intended use.

6.2 EXEMPTION OF LANDLORD FROM LIABILITY; WAIVER. Landlord shall not be liable for any damage or injury to the person, business (or any loss of income therefrom), goods, wares, merchandise or other property of Tenant, Tenant's employees, invitees, customers or any other person in or about the Premises, whether such damage or injury is caused by or results from: (a) fire, steam, electricity, water, gas or rain; (b) the breakage, leakage, obstruction or other defects of pipes, sprinklers, wires, appliances, plumbing, air condition or lighting fixtures or any other cause; (c) conditions arising in or about the Premises or upon other portions of any building of which the Premises is a part, or from other sources or places; or (d) any act or omission of any other tenant of any building of which the Premises is a part. Landlord shall not be liable for any such damage or injury even though the cause of or the means of repairing such

damage or injury are not accessible to Tenant. Tenant, as a material part of the consideration to be rendered to Landlord, hereby waives all claims against Landlord for the foregoing damages from any cause arising at any time. The provisions of this Section 6.2 shall not, however, exempt Landlord from liability for Landlord's gross negligence or willful misconduct.

6.3 TENANT'S OBLIGATIONS.

6.3.1 MAINTENANCE AND REPAIR. Tenant shall keep the Premises (including all nonstructural, interior and exterior areas, systems and equipment, all glass, glazing, window moldings, partitions, doors, door hardware, interior painting, fixtures and appurtenances thereof [including electrical, lighting, plumbing and plumbing fixtures]) in good order, condition and repair during the Sublease Term. Tenant shall promptly replace any portion of the Premises or system or equipment in the Premises which cannot be fully repaired regardless of whether the benefit of such replacement extends beyond the Sublease Term. Tenant shall also maintain a preventive maintenance contract providing for the regular inspection and maintenance of the heating and air conditioning system (including leaks around ducts, pipes, vents, or other pa of the air conditioning) by a licensed heating and air conditioning contractor. However, Landlord shall have the right, upon written notice to Tenant, to undertake the responsibility for preventive maintenance of the heating and air conditioning system, at Tenant's expense.* It is the intention of the Landlord and Tenant that, at all times during the Sublease Term, Tenant shall maintain the Premises in an attractive, first class and fully operative condition. *in the event Landlord determines that Tenant is maintaining the HVAC system in an unsatisfactory manner.

6.3.2 TENANT EXPENSE. All of Tenant's obligations to maintain and repair shall be accomplished at Tenant's sole expense. If Tenant refuses or neglects to repair properly as required hereunder and to the reasonable satisfaction of Landlord, Landlord may, on ten (10) days' prior notice (except that notice shall be required in case of emergency) enter the property and perform such repair and maintenance on behalf of Tenant without liability to Tenant for any loss or damage that may accrue to Tenant's merchandise, fixtures, or other property or to Tenant's business by reason thereof, and upon completion thereof, Tenant shall pay Landlord's costs for making such repairs plus five percent (5%) for overhead upon presentation of bill therefor, as additional rent. Said bill shall include interest at ten percent (10%) on said costs from the date of completion of repairs by Landlord.

6.4 LANDLORD'S OBLIGATIONS. Landlord shall be responsible for the maintenance and repair of structural portions of the Premises. As used herein, structural portions of the Premises shall only refer to the foundation and slabs, exterior walls, and exterior roof of the building in which the Premises is located. If Landlord is required to make repairs to structural portions by reason of Tenant's conduct or activities, Landlord may add the cost of such repairs to the rent which shall thereafter become due. If Tenant refuses or neglects to repair property as required hereunder, and to the reasonable satisfaction of Landlord as soon as reasonably possible after written demand, Landlord may make such repairs without liability to Tenant for any loss or damage that may accrue to Tenant's merchandise, fixtures or other property or to Tenant's business by reason thereof, and upon completion thereof, Tenant shall pay Landlord as additional rent Landlord's cost for making such repairs, plus five percent (5%) for overhead upon presentation of bill thereafter. Said bill shall include interest at ten percent (10%) per year on said costs from the date of completion of repairs by Landlord. The Tenant shall pay its pro rata

share, computed in accordance with Subsection 4.2.1 hereof, of all repairs by Landlord to the structural portions of the building where the Premises are located. All such amounts shall be due and payable upon five (5) days' written notice from Landlord.

6.5 ALTERATIONS, ADDITIONS, AND IMPROVEMENTS.

6.5.1 PROHIBITED ACTIONS. Tenant shall not make any alterations, additions or improvements to the Premises without Landlord's prior written consent, except for non-structural alterations which do not exceed Five Thousand Dollars ($5,000) in cost cumulatively over the Sublease Term and which are not visible from the outside of any building of which the Premises is part. Landlord may require Tenant to provide demolition and/or lien and completion bonds in form and amount satisfactory to Landlord. Tenant shall promptly remove any alterations, additions, or improvements constructed in violation of this Subsection 6.5.1 upon Landlord's written request. All alterations, additions, and improvements will be accomplished in good and workmanlike manner, in conformity with all applicable laws and regulations, and by a contractor approved by Landlord. Upon completion of any such work, Tenant shall provide Landlord with "as built" plans, copies of all construction contracts, and proof of payment for all labor and materials. Any additions to, or alterations of, the Premises, except moveable furniture and trade fixtures, shall become at once a part of the Premises and belong to Landlord. However, this shall not prevent the Tenant from installing trade fixtures, machinery or other trade equipment in conformance to all applicable ordinances of the above-specified city and county, and the same may be removed upon the termination of this Sublease, provided the Premises is not damaged by such removal, and Tenant shall not then be in default under the terms and conditions of this Sublease.

6.5.2 PAYMENT BY TENANT. Tenant shall pay when due all claims for labor and material furnished to the Premises. Tenant shall give Landlord at least thirty (30) days' prior written notice of the commencement of any work on the Premises. Landlord may elect to record and post notices of nonresponsibility on the Premises.

6.5.3 FREEDOM FROM LIENS. Tenant shall keep the Premises, all other property therein and the Building free from any liens arising out of any work performed, material furnished or obligations incurred by Tenant, and shall indemnify, hold harmless and defend Landlord from any liens and encumbrances arising out of any work performed or materials furnished by or at the direction of Tenant. In the event that Tenant shall not, within twenty (20) days following the imposition of any such lien, cause such lien to be released of record by payment or posting of a proper bond, Landlord shall have, in addition to all other remedies provided herein and by law, the right, but no obligation, to cause the same to be released by such means as it shall deem proper, including payment of the claim giving rise to such lien. All such sums paid by Landlord and all expenses incurred by it in connection therewith, including attorneys' fees and costs, shall be payable to Landlord by Tenant on demand with interest at the maximum rate allowed by law.

6.5.4 WRITTEN NOTIFICATION REQUIRED. Tenant will notify Landlord in writing thirty (30) days prior to commencing any alterations or additions to allow Landlord time to file notices of nonresponsibility. The Landlord reserves the right to approve any contractor and method of payment, prior to said contractor making any improvements to the Premises.

6.5.5 COMMON AREA CONSTRUCTION. Tenant acknowledges that from time to time Landlord may be required to construct, alter, or improve Common Areas within the Project. Landlord will attempt to minimize any disruption to Tenant's business, but Tenant hereby releases Landlord from any and all claims pertaining to such construction, alteration, or improvement not caused by Landlord's gross negligence or willful misconduct.

6.6 RULES AND REGULATIONS.

6.6.1 The Tenant agrees as follows:

(1) Landlord shall arrange for a trash collection service which will provide and periodically empty trash containers placed in designated areas for use by Tenant and other tenants in the Project. Tenant shall be responsible for placing all of its garbage and trash in such trash containers.

(2) No aerial shall be erected on the roof or exterior walls of the Premises, or on the grounds, without in each instance, the written consent of the Landlord. Any aerial so installed without such written consent shall be subject to removal without notice at any time.

(3) No loudspeakers televisions, phonographs, radios, or other devices shall be used in a manner so as to be heard or seen outside of the Premises without the prior written consent of the Landlord.

(4) The outside areas immediately adjoining the Premises shall be kept clean and free from dirt and rubbish by the Tenant to the satisfaction of the Landlord and Tenant shall not place or permit any obstruction or materials in such areas. No exterior storage shall be allowed without permission in writing from Landlord.

(5) The plumbing facilities shall not be used for any other purpose than that for which they are constructed, and no foreign substance of any kind shall be thrown therein, and the expense of any breakage, stoppage, or damage resulting from a violation of this provision shall be borne by Tenant who shall, or whose employees, agents or invitees shall have caused it.

(6) Tenant shall not burn any trash or garbage of any kind in or about the Premises, or the Project.

(7) The sidewalks, halls, passages, exits, entrances, and stairways in and about the Project shall not be obstructed by any of the tenants or used by them for any purpose other than for ingress to and egress from their respective Premises. The halls, passages, exits, entrances, stairways, balconies and roof are not for the use of the general public and the Landlord shall in all cases retain the right to control and prevent access thereto by all persons whose presence in the judgment of the Landlord shall be prejudicial to the safety, character, reputation and interests of the Project and their Tenants, provided that nothing herein contained shall be constructed to prevent such access to persons with whom the Tenant normally deals in the ordinary course of Tenant's business unless such persons are engaged in illegal activities. No Tenant and no employees or invitees of any Tenant shall go upon the roof of the building , except to maintain RVAC system per Paragraph 6.3.1.

(8) No additional locks or bolts of any kind shall be placed upon doors or windows by Tenant, nor shall any changes be made in existing locks or the mechanisms thereof. Tenant must, upon the termination of Tenant's tenancy, restore to Landlord all keys of stores, offices and toilet rooms either furnished to or otherwise procured by Tenant, and in the event of the loss of any keys so furnished Tenant shall pay to Landlord the cost thereof.

(9) No Tenant shall lay linoleum or other similar floor covering so that the same shall be affixed to the floor of the Premises in any manner except by a paste, or other material, which may easily be removed with water, the use of cement or other similar adhesive materials being expressly prohibited. The method of affixing any such linoleum or other similar floor covering to the floor, as well as the method of affixing carpets or rugs to the Premises, shall be subject to approval by Landlord. The expense of repairing any damage resulting from a violation of this rule shall be borne by Tenant by whom, or by whose agents, clerks, employees, or visitors, the damage shall have been caused.

(10) Tenant will not install blinds, shades, awnings, or other form of inside or outside window covering, or window ventilators or similar devices, without the prior written consent of Landlord.

Landlord reserves the right from time to time to amend or supplement the foregoing rules and regulations, and to adopt and promulgate additional rules and regulations applicable to the Premises. Notice of such rules and regulations and amendments and supplements thereto, if any, shall be given to the Tenant and Tenant agrees to comply with all such rules and regulations upon receipt of notice to Tenant from Landlord. Landlord shall not be liable in any way to Tenant for any damage or inconvenience caused by any other Tenant's non-compliance with these rules and regulations.

6.7 CONDITION UPON TERMINATION. Upon the termination of the Sublease, Tenant shall surrender the Premises to Landlord, broom-clean and in the same condition as received except for ordinary wear and tear which Tenant was not otherwise obligated to remedy under any provision of this Sublease. However, Tenant shall not be obligated to repair any damage which Landlord is required to repair under Article Seven (Damage or Destruction). In addition, Landlord may require Tenant to remove any alterations, additions or improvements (whether or not made with Landlord's consent) prior to the termination of the Sublease and to restore the Premises to its prior condition, all at Tenant's expense. All alterations, additions and improvements which Landlord has not required Tenant to remove shall become Landlord's property and shall be surrendered to Landlord upon the termination of the Sublease, except that Tenant may remove any of Tenant's machinery or equipment which can be removed without material damage to the Premises. Tenant shall repair, at Tenant's expense, any damage to the Premises caused by the removal of any such machinery or equipment. In no event, however, shall Tenant remove any of the following materials or equipment without Landlord's prior written consent: any power wiring or power panels; lighting or lighting fixtures; wall coverings; drapes, blinds or other window coverings; carpets or other floor coverings; heaters, air conditioners or any other heating or air conditioning equipment; fencing or security gates; or other similar building operating equipment and decorations.

6.8 MAINTENANCE OF COMMON AREAS. Landlord shall maintain the Common Areas as set forth in Section 4.5 above.

ARTICLE VII
DAMAGE OR DESTRUCTION

7.1 PARTIAL DAMAGE TO PREMISES. Tenant shall notify Landlord in writing immediately upon the occurrence of any damage to the Premises or the Building. If the Premises or the Building is only partially damaged and if the proceeds received by Landlord from the insurance policies described in Subsection 4.4.2 are sufficient to pay for the necessary repairs, this Sublease shall remain in effect and Landlord shall repair the damage as soon as reasonably possible. Landlord may elect to repair any damage to Tenant's fixtures, equipment, or improvements. If the insurance proceeds received by Landlord are not sufficient to pay the entire cost of repair, or if the cause of the damage is not covered by the insurance policies which Landlord maintains under Subsection 4.4.2, Landlord may elect either to (a) repair the damage as soon as reasonably possible, in which case this Sublease shall remain in full force and effect or (b) terminate this Sublease as of the date the damage occurred. Landlord shall notify Tenant within thirty (30) days after receipt of notice of the occurrence of the damage, whether Landlord elects to repair the damage or terminate the Sublease. If Landlord elects to repair the damage, Tenant shall pay Landlord the "deductible amount" (if any) under Landlord's insurance policies or the Tenant's pro rata share thereof if the Premises is a multi-tenant building, and, if the damage was due to an act or omission of Tenant, the difference between the actual cost of repair and any insurance proceeds received by Landlord. If Landlord elects to terminate this Sublease, Tenant may elect to continue this Sublease in full force and effect, in which case Tenant shall repair any damage to the Premises and any building in which the Premises is located. Tenant shall pay the cost of such repairs, except that, upon satisfactory completion of such repairs, Landlord shall deliver to Tenant any insurance proceeds received by Landlord for the damage repaired by Tenant. Tenant shall give Landlord written notice of such election within ten (10) days after receiving Landlord's termination notice. If the damage to the Premises occurs during the last six (6) months of the Sublease Term, Landlord may elect to terminate this Sublease as of the date the damage occurred, regardless of the sufficiency of any insurance proceeds and Landlord may retain all such proceeds. In such event, Landlord shall not be obligated to repair or restore the Premises and Tenant shall have no right to continue this Sublease. Landlord shall notify Tenant of its election within thirty (30) days after receipt of notice of the occurrence of the damage.

7.2 TOTAL OR SUBSTANTIAL DESTRUCTION. If the Premises is totally or substantially destroyed by any cause whatsoever, or if the Premises is in a building which is substantially destroyed (even though the Premises is not totally or substantially destroyed), this Sublease shall, at the election of the Landlord, terminate as of the date the destruction occurred regardless of whether Landlord receives any insurance proceeds. However, if the Premises can be rebuilt within one (1) year after the date of destruction, Landlord may elect to rebuild the Premises at Landlord's own expense (with all insurance proceeds being made available to the Landlord to apply against such costs), in which case, this Sublease shall remain in full force and effect. Landlord shall notify Tenant of such election within thirty (30) days after the occurrence

of total or substantial destruction. If the destruction was caused by an act or omission of Tenant, Tenant shall pay Landlord the difference between the actual cost of rebuilding and any insurance proceeds received by Landlord.

7.3 UNINSURED CASUALTY. In the event the Premises are destroyed to the extent of fifteen percent (15%) or more of the replacement value thereof by any casualty not covered under the fire and extended coverage insurance covered by Landlord or Tenant, then Landlord may elect to terminate this Sublease. In the event of such termination the rights and obligations of the parties hereunder shall cease. If the Landlord does not elect to so terminate, then the Landlord shall promptly commence repairing such damage at the Landlord's cost and expense.

7.4 LANDLORD'S OBLIGATIONS. Landlord shall not be required to repair any injury or damage by fire or other cause, or to make any restoration or replacement of any panelings, decorations, partitions, railings, floor coverings, office fixtures or any other improvements or property installed in the Premises by Tenant or at the direct or indirect expense of Tenant which are not part of the original Tenant improvements paid for by Landlord. Tenant shall be required to restore or replace same in the event of damage except for damage caused solely by the Landlord's negligence or intentional misconduct. Tenant shall have no claim against Landlord for any damage suffered by reason of any such damage, destruction, repair or restoration, nor shall Tenant have the right to terminate this Sublease as the result of any statutory provision now or hereafter in effect pertaining to the damage and destruction of the Premises, except as expressly provided herein.

7.5 TEMPORARY REDUCTION IN RENT. If the Premises are destroyed or damaged and Landlord or Tenant repairs or restores the Premises pursuant to the provisions of this Article Seven, any rent payable during the period of such damage, repair and/or restoration shall be reduced by the amount payable under any rental income insurance paid to Landlord. Except for such possible reduction in payments required from the Tenant, Tenant shall not be entitled to any compensation, reduction, or reimbursement from Landlord as a result of any damage, destruction, repair, or restoration of or to the Premises.

7.6 WAIVER. Tenant waives the protection of any statute, code or judicial decision which grants a tenant the right to terminate a sublease in the event of damage or destruction of the premises. Tenant agrees that the provisions of this Article Seven shall govern the rights and obligations of Landlord and Tenant in the event of any damage or destruction of the Premises.

## ARTICLE VIII
## CONDEMNATION

8.1 CONDEMNATION. If all or any portion of the Premises is taken under the power of eminent domain or sold under the threat of that power (all of which are called "Condemnation"), this Sublease shall terminate as to the part taken or sold on the date the condemning authority takes title or possession whichever occurs first. If more than twenty percent (20%) of the floor area of the Premises is taken, either Landlord or Tenant may terminate this Sublease as of the date the condemning authority take title or possession, by delivering written notice to the other within ten (10) days after receipt of written notice of such taking (or in the absence of such

notice, within ten (10) days after the condemning authority takes possession). If more than twenty percent (20%) of all subleaseable space in the building in which the Premises are located is taken the Landlord may elect to terminate this Sublease by delivering such notice to Tenant. If neither Landlord nor Tenant terminates this Sublease, this Sublease shall remain in effect as to the portion of the Premises not taken, except that the Base Rent shall be reduced in proportion to the reduction in the floor area of the Premises. Any Condemnation award or payment shall be distributed in the following order: (a) first, to any ground lessor, mortgagee or beneficiary under a deed of trust encumbering the Premises, the amount of its interest in the Premises and the Tenant hereby assigns any other rights which the Tenant may have now or in the future to any other award to the Landlord; (b) second, to Tenant, only the amount of any award specifically designated for loss of or damage to Tenant's trade fixtures or removable personal property, and the Tenant hereby assigns any other rights which the Tenant may have now or in the future to any other award to the Landlord, and (c) third, to Landlord, the remainder of such award, whether as compensation for reduction in the value of the subleasehold, the taking of the fee, or otherwise. If this Sublease is not terminated, Landlord shall repair any damage to the Premises caused by the Condemnation, except that Landlord shall not be obligated to repair any damage for which Tenant has been reimbursed by the condemning authority. If the severance damages received by Landlord are not sufficient to pay for such repair, Landlord shall have the right to either terminate this Sublease or make such repair at Landlord's expense.

## ARTICLE IX
## ASSIGNMENT AND SUBLETTING

9.1 LANDLORD'S CONSENT REQUIRED. No portion of the Premises or of Tenant's interest in this Sublease may be acquired by any other person or entity, whether by assignment, mortgage, sublease, transfer, operation of law, or act of Tenant, without Landlord's prior written consent, except as provided in Section 9.2 below. Any attempted transfer without consent shall be void and shall constitute a noncurable breach of this Sublease. If tenant is a partnership, (i) any cumulative transfer or more than twenty percent (20%) of the partnership interests, or (ii) the admission of a new general partner, or (iii) the transfer of any interest of any general partner in the partnership shall require Landlord's consent.

9.2 TENANT AFFILIATE. Tenant may assign this Sublease or sublease the Premises, without Landlord's consent, to any corporation which controls, is controlled by or is under common control with Tenant, or to any corporation resulting from the merger of or consolidation with Tenant ("Tenant's Affiliate"). In such case, any Tenant's Affiliate shall assume in writing all of Tenant's obligations under this Sublease, but the Tenant shall remain primarily liable hereunder.

9.3 NO RELEASE OF TENANT. No transfer permitted by this Article Nine, whether with or without Landlord's consent, shall release Tenant or change Tenant's primary liability to pay the rent and to perform all other obligations of Tenant under this Sublease. Landlord's acceptance of rent from any other person is not a waiver of any provision of this Article Nine. Consent to one transfer is not a consent to any subsequent transfer. If Tenant's transferee defaults under this Sublease, Landlord may proceed directly against Tenant without pursuing remedies against the transferee. Landlord may consent to subsequent assignments or

modifications of this Sublease by Tenant's transferee, without notifying Tenant or obtaining its consent. Such action shall not relieve Tenant's liability under this Sublease.

9.4 LANDLORD'S ELECTION Tenant's request for consent to any transfer described in Section 9.1 above shall be accompanied by a written statement setting forth the details of the proposed transfer, including the name, business and financial condition of the prospective transferee, financial details of the proposed transfer (e.g., the term of and rent and security deposit payable under any assignment or sublease), and any other information Landlord deems relevant. Landlord shall have the right (a) to withhold consent, if reasonable; (b) to grant consent; or (c) if the transfer is a sublease of the Premises or an assignment of this Sublease, to terminate this Sublease as of the effective date of such sublease or assignment, in which case Landlord may elect to enter into a direct sublease with the proposed assignee or subtenant.

9.5 NO MERGER. No merger shall result from Tenant's sublease of the Premises under this Article Nine, Tenant's surrender of this Sublease or the termination of this Sublease in any other manner. In any such event, Landlord may terminate any or all subtenancies or succeed to the interest of Tenant as sublandlord thereunder.

## ARTICLE X
## DEFAULTS; REMEDIES

10.1 COVENANTS AND CONDITIONS. Tenant's performance of each of Tenant's obligations under this Sublease is a condition as well as a covenant. Tenant's right to continue in possession of the Premises is conditioned upon such performance. Time is of the essence in the performance of all covenants and conditions

10.2 DEFAULTS. Tenant shall be in material default under this Sublease:

10.2.1 VACATION OR ABANDONMENT. If Tenant abandons or vacates the Premises or if such abandonment or vacation of the Premises results in the cancellation of any insurance described in Section 4.4; or

10.2.2 FAILURE TO PAY. If Tenant fails to pay rent or any other charge required to be paid to Tenant, as and when due; or

10.2.3 FAILURE TO PERFORM. If Tenant fails to perform any of Tenant's nonmonetary obligations under this Sublease for a period of fifteen (15) days after written notice from Landlord; provided that if more time is required to complete such performance, Tenant shall not be in default if Tenant commence such performance within the fifteen (15) day period and thereafter diligently pursues its completion. However, Landlord shall not be required to give such notice if Tenant's failure to perform constitute a non-curable breach of this Sublease. The notice required by this Subsection is intended to satisfy any and all notice requirements imposed by law on Landlord and is not in addition to any such requirement.

10.2.4 OTHER DEFAULTS. (i) If Tenant makes a general assignment or general arrangement for the benefit of creditors; (ii) If a petition for adjudication of bankruptcy or for

reorganization or rearrangement is filed by or against Tenant and is not dismissed within thirty (30) days; (iii) if a trustee or receiver is appointed to take possession of substantially all of Tenant's assets located at the Premises or of Tenant's interest in this Sublease and possession is not restored to Tenant within thirty (30) days; or (iv) if substantially all of Tenant's assets located at the Premises or of Tenant's interest in this Sublease is subjected to attachment, execution or other judicial seizure which is not discharged within thirty (30) days. If a court of competent jurisdiction determines that any of the acts described in this Subsection 10.2.4 is not default under this Sublease, and a trustee is appointed to take possession (or if Tenant remains a debtor in possession) and such trustee or Tenant transfers Tenant's interest hereunder, then Landlord shall receive as Additional Rent, the difference between the rent (or any other consideration) paid in connection with such assignment or sublease and the rent payable by Tenant hereunder.

10.3 REMEDIES. On the occurrence of any material default by Tenant, Landlord may, at any time thereafter, with or without notice or demand and without limiting Landlord in the exercise of any right or remedy which Landlord may have:

10.3.1 TERMINATION OF POSSESSION. Terminate Tenant's right to possession of the Premise by any lawful means, in which case this Sublease shall terminate and Tenant shall immediately surrender possession of the Premises to Landlord. In such event Landlord shall have the immediate right to re-enter and remove all persons and property and such property may be removed and stored in a public warehouse or elsewhere at the cost of, and for the account of Tenant, all without service of notice of resort to legal process and without being deemed guilty of trespass, or becoming liable for any loss or damage which may be occasioned thereby; and Landlord shall be entitled to recover from Tenant all damages incurred by Landlord by reason of Tenant's default, including (i) the worth at the time of the award of all Base Rent, Additional Rent and other charges which were earned or were payable at the time of the termination; (ii) the worth at the time of the award of the amount by which the unpaid Base Rent, Additional Rent and other charges which would have been earned or were payable after termination until the time of the award exceeds the amount of such rental loss that Tenant proves could have been reasonably avoided, (iii) the worth at the time of the award of the amount by which the unpaid Base Rent, Additional Rent and other charges which would have been payable for the balance of the term after the time of award exceeds the amount of such rental loss that Tenant proves could have been reasonably avoided; and (iv) any other amount necessary to compensate Landlord for all the detriment proximately caused by Tenant's failure to perform its obligations under the Sublease or which in the ordinary course of things would be likely to result therefrom, including, but not limited to, any cost or expenses incurred by Landlord in maintaining or preserving the Premises after such default, the cost of recovering possession of the Premises, expenses of reletting, including necessary renovation or alteration of the Premises, Landlord's reasonable attorneys fees incurred in connection therewith, and any real estate commissions or other such fees paid or payable. As used in subparts (i) and (ii) above, the "worth at the time of the award" is computed by allowing interest on unpaid amounts at the rate of fifteen percent (15%) per annum, or such lesser amount as may then be the maximum lawful rate. As used in subpart (iii) above, the "worth at the time of the award" is computed by discounting such amount at the discount rate of the Federal Reserve Bank of San Francisco at the time of the award, plus one percent (1%). If Tenant shall have abandoned the Premises, Landlord shall have the option of (i)

retaking possession of the Premises and recovering from Tenant the amount specified in this Subsection 10.3.1 or (ii) proceeding under Subsection 10.3.2.

10.3.2 MAINTENANCE OF POSSESSION. Maintain Tenant's right to possession, in which case this Sublease shall continue in effect whether or not Tenant shall have abandoned the Premises. In such event, Landlord shall be entitled to enforce all of Landlord's rights and remedies under this Sublease including the right to recover the rent as it becomes due hereunder.

10.3.3 OTHER REMEDIES. Pursue any other remedy now or thereafter available to Landlord under the laws or judicial decisions of the state in which the Premises is located.

10.4 THE RIGHT TO RELET THE PREMISES. Should Landlord elect to re-enter, as herein provided, or should it take possession pursuant to legal proceedings or pursuant to any notice provided for by law, it may either terminate this Sublease or it may from time to time without terminating this Sublease, make such alterations and repairs as may be necessary in order to relet the property, and relet said property or any part thereof for such term or terms (which may be for a term extending beyond the term of this Sublease) and at such rental or rentals and upon such other terms and conditions as Landlord in its sole discretion may deem advisable upon each such reletting all rentals received by the Landlord from such reletting shall be applied, first to the repayment of any indebtedness other than rent due hereunder from Tenant to Landlord; second, to the payment of any costs and expenses of such reletting, including brokerage fees and attorneys' fees and of costs of such alterations and repairs; third, to the payment of rent due and unpaid hereunder, and the residue, if any, shall be held by Landlord and applied in payment of future rent as the same may become due and payable hereunder. If such rentals received from such reletting during any month are less than that to be paid during that month by Tenant hereunder, Tenant shall pay any such deficiency to Landlord. Such deficiency shall be calculated and paid monthly. No such re-entry or taking possession of said property by Landlord shall be construed as an election on its part to terminate this Sublease unless a written notice of such intention be given to Tenant or unless the termination thereof be decree by a court of competent jurisdiction.

10.5 WAIVER OF RIGHTS OF REDEMPTION. Tenant hereby expressly waives any and all rights of redemption granted by or under any present or future laws in the event of Tenant being evicted or dispossessed for any cause, or in the event of Landlord obtaining possession of the Premises, by reason of the violation by Tenant of any of the covenants or conditions of this Sublease, or otherwise.

10.6 CUMULATIVE REMEDIES. Landlord's exercise of any right or remedy shall not prevent it from exercising any other right or remedy.

ARTICLE XI
PROTECTION OF CREDITORS

11.1 SUBORDINATION

11.1.1 LANDLORD'S ELECTION. This Sublease is and shall remain subordinate to the Master Lease. In addition, Landlord shall have the right to require Tenant to subordinate this Sublease to any other ground lease, deed of trust or mortgage encumbering the Premises, any advances made on the security thereof and any renewals, modifications, consolidations, replacements or extensions thereof whenever made or recorded. However, Tenant's right to quiet possession of the Premises during the Sublease Term shall not be disturbed if Tenant pays the rent and performs all of Tenant's obligations under this Sublease and is not otherwise in default. If any ground lessor, beneficiary or mortgagee elects to have this Sublease prior to the lien of its ground sublease, deed of trust or mortgage and gives written notice thereof to Tenant, this Sublease shall be deemed prior to such ground sublease, deed of trust or mortgage whether this Sublease is dated prior or subsequent to the date of said ground sublease, deed of trust or mortgage or the date of recording thereof.

11.1.2 ADDITIONAL DOCUMENTS. Tenant agrees to execute any documents required to effectuate such subordination or to make this sublease prior to the lien of any ground sublease, mortgage or deed of trust, as the case may be, and failing to do so within ten (10) days after written demand does hereby make, constitute and irrevocably appoint Landlord as Tenant's attorney-in-fact and in Tenant's name, place and stead, to do so.

11.2 ATTORNMENT. If Landlord's interest in the Premises is acquired by any ground lessor, beneficiary, under a deed of trust, mortgagee, or purchaser at a foreclosure sale, Tenant shall attorn to the transferee of or successor to Landlord's interest in the Premises and recognize such transferee or successor as Landlord under this Sublease. Tenant waives the protection of any statute or rule of law which gives or purports to give Tenant any right to terminate this Sublease or surrender possession of the Premises upon the transfer of Landlord's interest.

11.3 SIGNING OF DOCUMENTS. Tenant shall sign and deliver any instrument or documents necessary or appropriate to evidence any such attornment or subordination or agreement to do so. If Tenant fails to do so within (10) days after written request, Tenant hereby makes, constitutes and irrevocably appoints Landlord, or any transferee or successor of Landlord, the attorney-in-fact of Tenant to execute and deliver any such instrument or document.

11.4 ESTOPPEL CERTIFICATES.

11.4.1 LANDLORD'S REQUEST. Upon Landlord's written request, Tenant shall execute. acknowledge and deliver to Landlord a written statement certifying: (1) that none of the terms or provisions; of this Sublease have been changed (or if they have been changed, stating how they have been changed); (ii) that this Sublease has not been cancelled or terminated; (iii) the last date of payment of the Base Rent and other charges and the time period covered by such payment; and (iv) that Landlord is not in default under this sublease (or, if the Landlord is claimed to be in default, stating why). Tenant shall deliver such statement to Landlord within ten (10) days after Landlord's request. Any such statement by Tenant may be given by Landlord to

any prospective purchaser or encumbrancer of the Premises. Such purchaser or encumbrancer may rely conclusively upon such statement as true and correct.

11.4.2 FAILURE TO DELIVER. If Tenant does not deliver such statement to Landlord within such ten (10) day period, Landlord, and any prospective purchaser or encumbrancer, may conclusively presume and rely upon the following facts except as otherwise represented: (i) that the terms and provisions of this Sublease have not been changed resented by Landlord; (ii) that this Sublease has not been cancelled or terminated except as otherwise represented by Landlord; (iii) that not more than one month's Base Rent or other charges have been paid in advance; and (iv) that Landlord is not in default under the Sublease. In such event, Tenant shall be estopped from denying the truth of such facts.

11.5 TENANT'S FINANCIAL CONDITION. Within ten (10) days after written request from Landlord, Tenant shall deliver to Landlord such financial statements as are reasonably required by Landlord to verify the net worth of Tenant, or any assignee, subtenant, or guarantor of Tenant. In addition, Tenant shall deliver to any lender or proposed purchaser of the Premises designated by Landlord any financial statements required by such lender to facilitate the sale, financing or refinancing of the Premises. Tenant represents and warrants to Landlord that (a) each such financial statement is a true and accurate statement as of the date of such statement and (b) at all times after the date of any such statement during the Sublease Term or any extension thereof, Tenant's net worth, as stated therein, shall not be reduced. All financial statements shall be confidential and shall be used only for the purposes set forth herein.

## ARTICLE XII
## LEGAL COSTS

12.1 LEGAL PROCEEDINGS. Tenant or Landlord shall reimburse the other party, upon demand, for any costs or expense incurred by the other party in connection with any breach or default of Tenant or Landlord under this Sublease, whether or not suit is commenced or judgment entered. Such costs shall include legal fees and costs incurred for the negotiation of a settlement, enforcement of rights or otherwise. Furthermore, if any action for breach of or to enforce the provisions of this Sublease is commenced, the court in such action shall award to the party in whose favor a judgment is entered a reasonable sum as attorneys' fees and costs. Such attorneys' fees and costs shall be paid by the losing party in such action. Tenant shall also indemnify Landlord against and hold Landlord harmless from all costs, expenses, demands and liability incurred by Landlord if Landlord becomes or is made a party to any claim or action (a) instituted by Tenant or by any third party against Tenant, or by or against any person holding any interest or using the Premises by license of or agreement with Tenant; (b) for foreclosure of any lien for labor or material furnished to or for Tenant or such other person; (c) otherwise arising out of or resulting from any act or transaction of Tenant or such other person; or (d) necessary to protect Landlord's interest under this Sublease in a bankruptcy proceeding, or other proceeding under Title 11 of the United States Code, as amended. Tenant shall defend Landlord against any such claim or action at Tenant's expense with counsel reasonably acceptable to Landlord or, at Landlord's election, Tenant shall reimburse Landlord for any legal fee or costs incurred by Landlord in any such claim or action.

12.2 LANDLORD'S CONSENT. Tenant shall pay Landlord's reasonable attorneys' fees incurred in connection with Tenant's request for Landlord's consent under Article Nine (Assignment and Subletting) or in connection with any other act which Tenant proposes to do and which requires Landlord's consent, provided, however, such attorney's fees shall not exceed $2,500.

## ARTICLE XIII
## MISCELLANEOUS PROVISIONS

13.2 LANDLORD'S LIABILITY; CERTAIN DUTIES.

13.2.1 LANDLORD. As used in this Sublease, the term "Landlord" means only the current owner or owners of the leasehold estate under the Master Lease at the time in question. Each Landlord has obligated to perform the obligations of Landlord under this Sublease only during the time such Landlord owns such interest or title. Any Landlord who transfers its title or interest is relieved of all liability with respect to the obligations of Landlord under this Sublease to be performed on or after the date of transfer. However, each Landlord shall deliver to its transferee all funds previously paid by Tenant, if such funds have not yet been applied under the terms of this Sublease.

13.2.2 WRITTEN NOTICE. Tenant shall give written notice of any failure by Landlord to perform any of its obligations under this Sublease to Landlord and to the District, any ground lessor, mortgagee or beneficiary under any deed of trust encumbering the Premises whose name and address have been furnished to Tenant in writing. Landlord shall not be in default under this Sublease unless Landlord (or the District, or such ground lessor, mortgagee or beneficiary) fails to cure such non-performance within thirty (30) days after receipt of Tenant's notice. However, if such non-performance reasonably requires more than thirty (30) days to cure, Landlord shall not be in default if such cure is commenced within such thirty (30) day period and thereafter diligently pursued to completion.

13.3 SEVERABILITY. A determination by a court of competent jurisdiction that any provision of this Sublease or any part thereof is illegal or unenforceable shall not cancel or invalidate the remainder of such provision or this Sublease, which shall remain in full force and effect.

13.4 INTERPRETATION. The captions of the Articles or Sections of this Sublease are to assist the parties in reading this Sublease and are not a part of the terms or provisions of this Sublease. Whenever required by the context of this Sublease, the singular shall include the plural and the plural shall include the singular. The masculine, feminine and neuter genders shall each include the other. In any provision relating to the conduct, acts or omissions of tenant, the term "Tenant" shall include Tenant's agents, employees, contractors, invitees, successors or others using the Premises with Tenant's expressed or implied permission.

13.5 INCORPORATION OF PRIOR AGREEMENTS; MODIFICATIONS. This Sublease is the only agreement between the parties pertaining to the sublease of the Premises and

no other agreements are effective. All amendments to this Sublease shall be in writing and signed by all parities. Any other attempt at amendment shall be void.

13.6 NOTICES. All notices required or permitted under this Sublease shall be in writing and shall be personally delivered or sent by certified mail, return receipt requested, postage prepaid. Notices to Tenant shall be delivered to the address specified in Section 1.3 above, except that upon Tenant's taking possession of the Premises, the Premises shall be Tenant's address for notice purposes. Notice to Landlord shall be delivered to the address specified in Section 1.2 above. All notices shall be effective upon personal delivery or three (3) days after deposit in the U.S. Mail. Either party may change its notice address upon written notice to the other party.

13.7 WAIVERS. All waivers must be in writing and signed by the waiving party. Landlord's failure to enforce any provision of this Sublease or its acceptance of rent shall not be a waiver and shall not prevent Landlord from enforcing that provision or any other provision of this Sublease in the future. No statement on a payment check from Tenant or in a letter accompanying a payment check shall be binding on Landlord. Landlord may with or without notice to Tenant, negotiate such check without being bound to the conditions of such statement.

13.8 NO RECORDATION. Tenant shall not record this Sublease without prior written consent from Landlord. However, Landlord may require that a "Short Form" memorandum of this Sublease be executed by both parties and recorded.

13.9 BINDING EFFECT; CHOICE OF LAW. This Sublease binds any party who legally acquires any rights or interest in this Sublease from Landlord or Tenant. However, Landlord shall have no obligation to Tenant's successor unless the rights or interests of Tenant's successor are acquired in accordance with the terms of this Sublease. The laws of the state in which the Premises are located shall govern this Sublease.

13.10 CORPORATE AUTHORITY; PARTNERSHIP AUTHORITY. If Tenant is a corporation each person signing this Sublease on behalf of Tenant represents and warrants that he has full authority to do so and that this Sublease binds the corporation. Within five (5) days after this Sublease is signed, Tenant shall deliver to Landlord a certified copy of a resolution of Tenant's Board of Directors authorizing the execution of this Sublease or other evidence of such authority reasonably acceptable to Landlord. Tenant is a partnership, each person signing this Sublease for Tenant represents and warrants that he is a general partner of the partnership, that he has full authority to sign for the partnership and that this Sublease binds the partnership and all general partners of the partnership. Tenant shall give written notice to Landlord of any general partner's withdrawal or addition. Within five (5) days after this Sublease is signed, Tenant shall deliver to Landlord a copy of Tenant's recorded statement of partnership or certificate of limited partnership.

13.11 JOINT AND SEVERAL LIABILITY. All parties signing this Sublease as Tenant shall be jointly and severally liable for all obligations of Tenant.

13.12 FORCE MAJEURE. If Landlord cannot perform any of its obligations due to events beyond Landlord's control, the time provided for performing such obligations shall be extended

by a period of time equal to the duration of such events. Events beyond Landlord's control include, but are not limited to, acts of God, war, civil commotion, labor disputes, strikes, fire, flood or other casualty, shortage of labor or material, government regulation or restriction and weather conditions.

13.13 NO OPTION. The submission of this Sublease for examination does not constitute a reservation of or option to sublease the Premises and this Sublease becomes effective only upon execution and delivery thereof by Landlord and Tenant.

LANDLORD:

GAP PORTFOLIO PARTNERS,
a New York general partnership

By: Colony Advisors, Inc.
its authorized agent

By: /s/ Thomas F. Harrison

Name: Thomas F. Harrison

Title: Senior Vice President

Signed on April 26, 1993

at San Diego, California

TENANT:

Camino Laboratories, a Delaware corporation

By: /s/ Hazel Marie Allen /s/ Jack Rinds

Its: Vice President Controller

ADDITIONAL PROVISIONS
SUBLEASE RIDER

This Additional Provisions Sublease Ride ("Rider") is attached to and made a part of that certain Industrial Real Estate Triple Net Sublease dated April 1, 1993, between GAP Portfolio Partners, a New York General Partnership, as Landlord, and Camino Laboratories, a Delaware corporation as Tenant, covering the Premises commonly known as 5955 Pacific Center Boulevard, Sand Diego, California (the "Sublease"). The terms used in this Rider shall have the same definitions as set forth in the Sublease and the other riders attached to and a part of the Sublease. The provisions of this Rider shall supersede any inconsistent or conflicting provisions of the Sublease, including the other riders attached to and a part of the Sublease.

1. The Additional Rent charges per Paragraph 1.9.2 shall not exceed the dollar amounts delineated below:

| Calendar Year | Amounts per square foot per month |
|---|---|
| 1993 | $.181 |
| 1994 | .186 |
| 1995 | .192 |
| 1996 | .198 |
| 1997 | .204 |
| 1998 | .210 |
| 1999 | .216 |
| 2000 | .222 |
| 2001 | .229 |
| 2002 | .236 |
| 2003 | .243 |

2. Quiet Possession and Nondisturbance: If Tenant pays the rent and complies with all other terms of this Sublease, Tenant may occupy and enjoy the Premises for the full Sublease term. In the event of a foreclosure sale or conveyance in lieu of such foreclosure, so long as there shall not then exist any breach or default on the part of the Tenant under this Sublease, or any event or condition which, with the giving of notice and/or the passage of time, could become such a breach or default, or any other event that would permit the Tenant's leasehold interest under this Sublease to be terminated, and subject to compliance by the Tenant with the terms hereof, (a) the Tenant's right to possession of the leased Premises and leasehold interest under this Sublease shall not be disturbed and shall continue in effect, and (b) the purchaser or transferee shall recognize and accept the Tenant as tenant under the terms, requirements and provisions of this Sublease.

# TENANT IMPROVEMENT
# SUBLEASE RIDER

This Tenant Improvement Sublease Rider ("Rider") is attached to and made a part of that certain Industrial Real Estate Triple Net Sublease dated April 1, 1993, between GAP Portfolio Partners, a New York General Partnership, as Landlord, and Camino Laboratories, a Delaware corporation as Tenant, covering the Premises commonly known as 5955 Pacific Center Boulevard, San Diego, CA 92121 (the "Sublease"). The terms used in this Rider shall have the same definitions as set forth in the Sublease. The provisions of this Rider shall supersede any inconsistent or conflicting provisions of the Sublease.

1. LANDLORD'S OBLIGATION.

1.1 Landlord shall be responsible for painting interior office walls; cleaning or replacing all carpeting at direction of Tenant; trimming trees in front of building to make "Camino Labs" sign visible; adding wall in old instrument area; and, installing new sinks in RI and QA labs.

OPTION TO EXTEND TERM
SUBLEASE RIDER

This Option to Extend Term Sublease Rider ("Rider") is attached to and made a part of that certain Industrial Real Estate Triple Net Sublease dated April 1, 1993, between GAP Portfolio Partners, a New York General Partnership, as Landlord, and Camino Laboratories, a Delaware corporation, as Tenant, covering the Premises commonly known as 5955 Pacific Center Boulevard, San Diego, CA 92121 (the "Sublease"). The terms used in this Rider shall have the same definitions as set forth in the Sublease. The provisions of this Rider shall supersede any inconsistent or conflicting provisions of the Sublease.

1. OPTION(S) TO EXTEND TERM.

1.1 GRANT OF OPTION. Landlord hereby grants to Tenant (3) option (s) (the "Option(s)") to extend the Sublease Term for additional term(s) of (2) years each (the "Extension(s)"), on the same terms and conditions as set forth in the Sublease, but at an increased rent as set forth below.

1.1.1 Each Option shall be exercised only by written notice delivered to Landlord at least one hundred eighty (180) days before the expiration of the Sublease Term or the preceding Extension of Sublease Term, respectively. If Tenant fails to deliver Landlord written notice of the exercise of an Option within the prescribed time period, such Option and any succeeding Options shall lapse, and there shall be no further right to extend the Sublease Term.

1.1.2 Each Option shall be exercisable by Tenant on the express conditions that (i) at the time of the exercise, and at all times prior to the commencement of such Extension, Tenant shall not be in default under any of the provisions of the Sublease, and (ii) Tenant has not been ten (10) or more days late on the payment of rent more than a total of three (3) times during the Sublease Term and all preceding Extensions.

1.2 PERSONAL OPTIONS. The Option(s) are personal to the Tenant named in Section 1.3 of the Sublease or any Tenant's Affiliate described in Section 9.2 of the Sublease and cannot be transferred.

1.2.1 If Tenant subleases any portion of the Premises or assigns or otherwise transfers an interest under the Sublease to an entity other than a Tenant Affiliate prior to the exercise of an Option (whether with or without Landlord's consent), such Option and any succeeding Options shall lapse.

1.2.2 If Tenant subleases any portion of the Premises or assigns or otherwise transfers an interest of Tenant under the Sublease to an entity other than a Tenant Affiliate after the exercise of an Option but prior to the commencement of the respective Extension (whether with or without Landlord's consent), such Option and any succeeding Options shall lapse and the Sublease Term shall expire if such Option were not exercised.

1.2.3 If Tenant subleases any portion of the Premises or assigns or otherwise transfers an interest of Tenant under the Sublease in accordance with Article 9 of the Sublease after the exercise of an Option and after the commencement of the Extension related to such Option, then the term of the Sublease shall expire upon the expiration of the Extension during which such sublease or transfer occurred and only the succeeding Options shall lapse.

2. CALCULATION OF RENT

The Base Rent during the first year of the first extension only, shall b ninety percent (90%) of the preceding year rent. Thereafter, the Base Rent during any subsequent extensions shall continue to increase on each annual anniversary of the Commencement Date as described in Section 1.9.1 of the Sublease.

[Floorplan of Building 6]

BUILDING # 6

CAMINO LABS

EXHIBIT A

[Layout of Richardson Pacific Commerce Center]

EXHIBIT B

EXHIBIT C

[Original Concept Design]

SORRENTOVIEW

INDUSTRIAL REAL ESTATE TRIPLE NET SUBLEASE

January 15, 1997

LANDLORD: Sorrento Montana, L.P.,
a California Limited Partnership

TENANT: Camino NeuroCare, Inc., A Delaware Corporation

SORRENTOVIEW

INDUSTRIAL REAL ESTATE TRIPLE NET SUBLEASE

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SORRENTOVIEW

INDUSTRIAL REAL ESTATE TRIPLE NET SUBLEASE

ARTICLE 1
BASIC TERMS

This Article One contains the Basic Terms of this Sublease between the Landlord and Tenant named below. This Sublease is subject to the Master Lease identified in Section 2.1 below. Other Articles, Sections, and Subsections of this Sublease referred to in this Article One explain and define the Basic Terms and are to be read in conjunction with the Basic Terms.

1.1 DATE OF SUBLEASE. January 15, 1997

1.2 LANDLORD. Sorrento Montana, L.P., a California Limited Partnership

Address of Landlord: c/o CDS Properties Services, Inc.,
d/b/a Sorrento Management Company
10211 Pacific Mesa Boulevard, Suite 406
San Diego, California 92121

1.3 TENANT. Camino NeuroCare, Inc., a Delaware Corporation

Address of Tenant: 5955 Pacific Center Boulevard
San Diego, California 92121

1.4 PREMISES. In consideration of the rents, covenants, and agreement on the part of the Tenant to be paid and performed, Landlord subleases to Tenant, and Tenant subleases from Landlord, those certain premises identified on Exhibit "A" attached hereto and by this reference incorporated herein (the "Premises"). The Premises contain approximately Eight Thousand Two Hundred (8,200) square feet of space, and are situated within that certain building ("Building") known as Building Seven (7) and located at 5965 Pacific Center Boulevard, Suites #709 through #713, San Diego, California 92121.

1 The Building is situated within that certain project ("Project") known as SORRENTOVIEW, located at the east side of Pacific Mesa Boulevard, between Pacific Mesa Court and Pacific Center Boulevard, San Diego, California, more particularly identified on Exhibit "B" attached hereto and by this reference incorporated herein.

1.5 SUBLEASE TERM. Thirty Six (36) months, beginning on the earlier of (a) the date Premises are delivered to Tenant by Landlord, or (b) January 15, 1997 or such other date as is specified in this Sublease (the "Sublease Term") (See Article 2).

1.6 PERMITTED USES. The Premises shall be used and occupied only for Medical Device Manufacturing, Warehousing, Distribution, and Directly Related Administrative Uses (See Section 5.1).

1.7 TENANT'S GUARANTOR. (IF NONE, SO STATE) None.

1.8 INITIAL SECURITY DEPOSIT. (See Section 3.3) Five Thousand Three Hundred Thirty and 00/100 Dollars ($5,330.00).

1.9 RENT AND OTHER CHARGES PAYABLE BY TENANT.

1.9.1 BASE RENT. The base rent ("Base Rent") shall be Five Thousand Three Hundred Thirty and 00/100 Dollars ($5,330.00) per month for the first Twelve (12) months, as provided in Section 3.1, then Base Rent shall be increased on each annual anniversary of the Commencement Date, beginning on the first anniversary of the Commencement Date, by three percent (3%) of the Base Rent in effect during the immediately preceding one year period. If the Commencement Date does not occur on the first day of the month, then the foregoing adjustments to Base Rent shall occur on the first day of the month in which the Commencement Date occurs.

1.9.2 OTHER PERIODIC PAYMENTS; ADDITIONAL RENT. (i) Real Property Taxes; (ii) utilities; (iii) insurance premiums; (iv) Common Area Costs; (v) impounds for insurance premiums and Real Property Taxes; (vi) maintenance, repairs, and alterations (See Articles Four and Six).

1.10 RIDERS. The following Riders are attached to and made a part of this Sublease: (If none, so state) Tenant Improvement Sublease Rider, Additional Provisions Sublease

1.11 BROKERS. (See Section 13.14). Tenant is represented by Gilbert Enciso/GE Commercial Real Estate. No other brokers are involved with this transaction.

ARTICLE II
SUBLEASE TERM

2.1 MASTER LEASE. Landlord is the ground lessee of the real property improved with and identified as the Project under that certain Lease dated August 25, 1987, by and between the San Diego Unified School District ("District") as lessor and Landlord as lessee (the "Master Lease"). The Master Lease provided that Landlord may construct improvements and sublease portions thereof to tenants. Accordingly, and subject to the Master Lease, Landlord is entering into this sublease with Tenant.

2.2 SUBLEASE OF PREMISES FOR SUBLEASE TERM. Landlord subleases the Premises to Tenant and Tenant subleases the Premises from Landlord for the Sublease Term. The Sublease Term is for the period stated in Section 1.5 above and shall begin and end on the

dates specified in Section 1.5 above, unless the beginning or end of the Sublease Term is changed under any provision of this Sublease. The "Commencement Date" shall be the date specified in Section 1.5 above for the beginning of the Sublease Term, unless advanced or delayed under any provision of this Sublease.

2.3 DELAY IN COMMENCEMENT. Deleted.

2.4 EARLY OCCUPANCY. If Tenant occupies the Premises prior to the Commencement Date, Tenant's occupancy of the Premises shall be subject to all of the provisions of this Sublease, except for payment of Rent. Early occupancy of the Premises shall not advance the expiration date of this Sublease.

2.5 HOLDING OVER. Tenant shall vacate the Premises upon the expiration or earlier termination of this Sublease. Tenant shall reimburse Landlord for and indemnify Landlord against all damages, loss or liability (including reasonable attorneys' fees and costs) incurred by Landlord from any delay by Tenant in vacating the Premises. If Tenant remains in possession of all or any part of the Premises after the expiration of the term hereof without the express consent of Landlord, such tenancy shall be from month-to-month only and not a renewal hereof or an extension for any further term, and in such case, Base Rent then in effect shall be increased by fifty percent (50%) and other monetary sums due hereunder shall be payable in the amount and at the time specified in this Sublease; and such month-to-month tenancy shall be subject to every other term, covenant and agreement contained herein, except that the month-to-month tenancy will be terminable on thirty (30) days notice given at any time by either party.

2.6 SURRENDER OF PREMISES. Upon the termination of the Sublease, Tenant shall surrender the Premises to Landlord in the condition specified in and according to Section 6.7.

## ARTICLE III
## BASE RENT

3.1 TIME AND MANNER OF PAYMENT. Upon execution of this Sublease, Tenant shall pay Landlord the Base Rent in the amount stated in Subsection 1.9.1 above for the first month of the Sublease Term. On the first day of the second month of the Sublease Term and each month thereafter, Tenant shall pay Landlord the Base Rent in United States currency, in advance, without offset, deduction or prior demand. The Base Rent shall be payable at Landlord's address or at such other place as Landlord may designate in writing.

3.2 INCREASE. The Base Rent shall be increased at the times specified in Subsection 1.9.1 above. Tenant shall be obligated to pay the new Base Rent from its effective date until the next periodic increase without any prior notice from Landlord.

3.3 SECURITY DEPOSIT INCREASES.

3.3.1 DEPOSIT. Upon the execution of this Sublease, Tenant shall deposit with Landlord a cash security deposit in the amount set forth in Section 1.8 above (the "Security

Deposit"). Landlord may apply all or part of the Security Deposit to any unpaid rent or other charges due from Tenant or to cure any other defaults of Tenant. Tenant hereby waives the provisions of Section 1950.7 of the California Civil Code, and all other provisions of law, now or hereafter in force, which provide that Landlord may claim from a security deposit only those sums reasonably necessary to remedy defaults in the payment of rent, to repair damage caused by Tenant or to clean the Premises, it being agreed that Landlord may, in addition, claim those sums reasonably necessary to compensate Landlord for any other loss or damage, foreseeable or unforeseeable, caused by the act or omission of Tenant or any officer, employee, agent or invitee of Tenant. If Landlord uses any part of the Security Deposit, Tenant shall restore the Security Deposit to its full amount within ten (10) days after Landlord's written request. Tenant's failure to do so shall be a material default under this Sublease. No interest shall be paid on the Security Deposit. Landlord shall not be required to keep the Security Deposit separate from its other accounts and no trust relationship is created with respect to the Security Deposit.

3.3.2 INCREASE IN DEPOSIT. Deleted.

3.4 TERMINATION; ADVANCE PAYMENTS. Upon termination of this Sublease under Article Seven (Damage or Destruction), Article Eight (Condemnation), or any other termination not resulting from Tenant's default, and after Tenant has vacated the Premises in the manner required by this Sublease, an equitable adjustment shall be made concerning advance Rent, any other advance payments made by Tenant to Landlord, and accrued Real Property Taxes, and Landlord shall refund the unused portion of the Security Deposit to Tenant or Tenant's successor.

## ARTICLE IV
## OTHER CHARGES PAYABLE BY TENANT

4.1 ADDITIONAL RENT. All charges payable by Tenant other than Base Rent are called "Additional Rent." Unless this Sublease provides otherwise, all Additional Rent shall be paid with the next monthly installment of Base Rent and shall be in United States currency. The term "Rent" shall mean Base Rent and Additional Rent.

4.2 REAL PROPERTY TAXES.

4.2.1 PAYMENT OF TAXES. Tenant shall pay its proportionate share of all Real Property Taxes levied and assessed against the Project. Tenant's proportionate share of Real Property Taxes shall be the ratio that the total number of square feet in the Premises bears to the total number of leasable square feet in the Project existing upon the date the computation is made. Each year Landlord shall notify Tenant of Landlord's calculation of Tenant's proportionate share of the Real Property Taxes and together with such notice shall furnish Tenant with a copy of the tax bill. If any supplemental tax bills are delivered with respect to the Project, Landlord may notify Tenant of Landlord's new calculation of Tenant's proportionate share of Real Property Taxes as soon as such supplemental tax bill is received. Subject to Section 4.8 below, Tenant shall reimburse Landlord for Tenant's proportionate share of Real Property Taxes semiannually no later than fifteen (15) days before the taxing authority's delinquency date.

4.2.2 DEFINITION OF "REAL PROPERTY TAXES". "Real Property Taxes" means (i) any fee, license fee, license tax, commercial rental tax, levy, charge, assessment, penalty or tax (other than inheritance or estate taxes) imposed by any authority having the direct or indirect power to tax, including any City, County, State or Federal government, or any school, agriculture, lighting, drainage or other improvement district thereof, as against any legal or equitable interest of Landlord in the Premises; (ii) any tax on the Landlord's right to receive, or the receipt of, rent or income from the Premises or against Landlord's business of leasing the Premises; (iii) any tax or charge for fire protection, streets, sidewalks, road maintenance, refuse or other services provided to the Premises by any governmental agency; (iv) any tax imposed upon this transaction or based upon a reassessment of the Premises due to a change in ownership or transfer of all or part of Landlord's interest in the Premises; and (v) any charge or fee replacing any tax previously included within the definition of Real Property Taxes. "Real Property Taxes" does not, however, include Landlord's Federal or State income, franchise, inheritance or estate taxes.

4.2.3 PERSONAL PROPERTY TAXES.

(a) Tenant shall pay prior to delinquency all taxes charged against trade fixtures, furnishings, equipment or any other personal property belonging to Tenant. Tenant shall attempt to have such personal property taxed separately from the Premises.

(b) If any such taxes on Tenant's personal property are levied against Landlord or Landlord's property, or if the assessed value of the Premises is increased by the inclusion therein of a value placed upon such personal property or trade fixtures of Tenant, then Landlord, after written notice to Tenant, shall have the right to pay the taxes based upon such increased assessments, regardless of the validity thereof, but only under proper protest if requested by Tenant in writing. If Landlord shall do so, then Tenant shall, upon demand, repay to Landlord the taxes levied against Landlord, or the proportion of such taxes resulting from such increase in the assessment. In any such event, however, Tenant, at Tenant's sole cost and expense, shall have the right, in the name of Landlord and with Landlord's cooperation, to bring suit in any court of competent jurisdiction to recover the amount of any such taxes so paid under protest; any amount so recovered to belong to the Tenant.

(c) If any of Tenant's personal property is taxed with the Premises, Tenant shall pay Landlord the taxes for the personal property within fifteen (15) days after Tenant receives a written statement from Landlord for such personal property taxes.

4.3 UTILITIES. Tenant shall arrange for and pay, directly to the appropriate supplier, the cost of all natural gas, heat, light, power, sewer, telephone, water and other utilities and services supplied to the Premises. Landlord will cooperate in attempting to have each of the utilities supplied to the Premises separately metered. However, if any such utilities or services are jointly metered with other premises within the Project, Landlord shall make a reasonable determination of Tenant's proportionate share of the cost for such utilities and services, based on information reasonably available to Landlord, and Tenant shall pay such share to Landlord within fifteen (15) days after receipt of Landlord's written statement of such cost.

4.4 INSURANCE.

4.4.1 LANDLORD'S LIABILITY INSURANCE. During the Sublease Term, Landlord shall maintain a policy of commercial general liability insurance at Tenant's expense, insuring Landlord against liability arising out of the ownership, use, occupancy or maintenance of the Premises. The initial amount of such insurance shall be at least $2,000,000.00 and shall be subject to periodic increase based upon inflation, increased liability awards, recommendations of professional insurance advisers, and other relevant factors. However, the amount of such insurance shall not limit Tenant's liability nor relieve Tenant or any obligation hereunder. Tenant shall, at Tenant's expense, maintain such other liability insurance as required pursuant to Subsections 4.4.6 and 4.4.7 hereof.

4.4.2 LANDLORD'S HAZARD AND RENTAL INCOME INSURANCE. During the Sublease Term, Landlord shall, at Tenant's expenses, maintain policies of insurance covering loss of or damage to the Premises to the extent of at least one hundred percent (100%) of its replacement value. Such policies shall provide protection against all perils included within the classification of fire, extended coverage, vandalism, malicious mischief, and any other perils which Landlord reasonably deems necessary. Landlord may obtain insurance coverage for Tenant's fixtures, equipment or building improvements installed by Tenant in or on the Premises. Tenant shall, at Tenant's expense, maintain such primary or additional insurance on its fixtures, equipment and building improvements as is required pursuant to Subsections 4.4.6 and 4.4.7 hereof. During the Sublease Term, Landlord may also maintain a rental income insurance policy at Tenant's expense, with loss payable to Landlord in an amount equal to one year's Rent. Tenant shall not do or permit to be done anything which invalidates any such insurance policies.

4.4.3 PAYMENT OF PREMIUMS; INSURANCE POLICIES. Tenant shall pay its pro rata share of the premiums for maintaining the insurance required by Subsections 4.4.1 and 4.4.2. Tenant's pro rata share of all such premiums shall be based on the same proportion as used for payment of taxes pursuant to Subsection 4.2.1 hereof. All such amounts will be due and payable upon ten (10) days written notice.

4.4.4 INCREASE IN FIRE INSURANCE PREMIUM. Tenant agrees that it will not keep, use, manufacture, assemble, sell or offer for sale in or upon the Premises any article which may be prohibited by the standard form of fire insurance policy. Tenant agrees to pay any increase in premiums for fire and extended coverage insurance that may be charged during the term of this Sublease on the amount of such insurance which may be carried by Landlord on said Premises or the Building, resulting from the acts or omissions of Tenant, its agents, servants or employees, or the use or occupancy of the Premises by Tenant or from the type of materials or products stored, manufactured, assembled or sold by Tenant in the Premises, whether or not Landlord has consented to the same. In determining whether increased premiums are the result of Tenant's use of the Premises, a schedule, issued by the organization making the insurance rate on the Premises, showing the various components of such rate, shall be conclusive evidence of the several items and charges which make up the fire insurance rate on the Premises.

4.4.5 WAIVER OF SUBROGATION. Landlord and Tenant each hereby release and relieve the other, and waive their entire right to recover damages (whether in contract or in tort)

against the other, for loss or damage arising out of or incident to the perils required to be insured against under Section 4.4. The effect of such releases and waivers of the right to recover damages shall not be limited by the amount of insurance carried or required, or by any deductibles applicable thereto. Landlord and Tenant agree to have their respective insurance companies issuing property damage insurance waive any right to subrogation that such companies may have against Lessor or Lessee, as the case may be, so long as the insurance is not invalidated thereby.

4.4.6 TENANT'S REQUIRED INSURANCE. Tenant shall keep in force throughout the Sublease Term: (a) a commercial general liability insurance policy or policies to protect the Landlord Entities against any liability to the public or to any invitee of Tenant or a Landlord Entity incidental to the use of or resulting from any accident occurring in or upon the Premises with a limit of not less than $1,000,000.00 per occurrence and not less than $2,000,000.00 in the annual aggregate, or such larger amount as Landlord may prudently require from time to time, covering bodily injury, personal injury, property damage and contractual liability and $1,000,000 products/completed operations aggregate; (b) Business Auto Liability covering owned, non-owned and hired vehicles with a limit of not less than $1,000,000 per accident; (c) insurance protecting against liability under Worker's Compensation Laws with limits at least as required by statute; (d) Employer's Liability with limits of $500,000 each accident, $500,000 disease policy limit, $500,000 disease - each employee; (e) All Risk or Special Form coverage protecting Tenant against loss or damage to Tenant's alterations, additions, improvements, carpeting, floor coverings, paneling, decorations, fixtures, inventory, and other personal property situated in or about the Premises to the full replacement value of the property so insured; and (f) such other reasonable types of insurance and in such reasonable amounts covering the Premises and operations therein as Landlord may reasonably require from time to time. The term "Landlord Entities" shall mean Landlord and any other person or entity that Landlord may designate from time to time.

4.4.7 REQUIRED INSURANCE POLICIES. Each of the policies required under Section 4.4.6 shall (a) be provided at Tenant's expense; (b) name the Landlord Entities as additional insureds; (c) be issued by an insurance company with a minimum Best's rating of "A:VII" during the Sublease Term; (d) provide that said insurance shall not be canceled unless thirty (30) days prior written notice (ten days for non-payment of premium) shall have been given to Landlord; and (e) be primary to and not contributory with any similar insurance carried by Landlord. Said policy or policies or certificates thereof shall be delivered to Landlord by Tenant upon the Commencement Date and at least thirty (30) days prior to each renewal of said insurance.

4.4.8 ADDITIONAL LIABILITY; UNDER CONSTRUCTION. Whenever Tenant shall undertake any alterations, additions or improvements in, to or about the Premises ("Work") the aforesaid insurance protection must extend to and include injuries to persons and damage to property arising in connection with such Work, together with such other insurance as Landlord shall require; and the policies of or certificates evidencing such insurance must be delivered to Landlord prior to the commencement of any such Work.

4.5 COMMON AREAS.

4.5.1 DEFINITION; LOCATION. As used in this Sublease, "Common Areas" shall mean all areas within the Project which are available for the common use of tenants of the Project and which are not leased or held for the exclusive use of tenants of the Project or which are not leased or held for the exclusive use of Tenant or other tenants, including, but not limited to, parking areas, driveways, sidewalks, loading areas, retaining walls, truck service ways, pedestrian malls, stairs, ramps, restrooms, access roads, corridors, landscaping, planted areas and trash enclosures. Landlord may from time to time change the size, location, nature and use of the Common Areas, including converting Common Areas into leasable areas, construction of additional parking facilities (including parking structures) in the Common Areas, and increasing or decreasing Common Area land and/or facilities. Tenant acknowledges that such activities may result in occasional inconvenience to Tenant from time to time. Landlord will exercise good faith efforts to minimize any disruption to Tenant's business caused by such activities, but Tenant hereby releases Landlord from any and all claims pertaining to such activities.

4.5.2 USE OF COMMON AREAS. Subject to other provisions of this Sublease, Tenant shall have the nonexclusive right (in common with other tenants and all others to whom Landlord has granted or may grant such rights) to use the Common Areas for the purposes intended, subject to such reasonable rules and regulations as Landlord may establish from time to time. Tenant shall abide by such rules and regulations and shall use its best effort to cause others who use the Common Areas with Tenant's expressed or implied permission to abide by Landlord's rules and regulations. At any time, Landlord may close any Common Areas to perform any acts in and to the Common Areas as, in Landlord's judgment, may be desirable to improve the Project. Tenant shall not, at any time, intentionally interfere with the rights of Landlord, other tenants, or any other person entitled to use the Common Areas.

4.5.3 VEHICLE PARKING. Tenant shall be entitled to use 3.8 vehicle parking spaces in the Project for each 1,000 (One Thousand) square feet (a total of thirty-one (31) spaces) within the Premises without paying any additional rent. Tenant's parking shall not be reserved and shall be limited to vehicles no larger than standard size automobiles or pickup or utility vehicles. Tenant shall not cause large trucks or other large vehicles to be parked within the Project. Vehicles shall be parked only in striped parking spaces and not in driveways, loading areas or other locations not specifically designated for parking. If Tenant parks more vehicles in the parking area than the number identified herein, such conduct shall be a material breach of this Sublease. No vehicle may be parked at the Project for more than seventy-two (72) consecutive hours without Landlord's prior written consent.

4.5.4 MAINTENANCE OF COMMON AREAS. Landlord shall maintain the Common Areas in good order, condition and repair and shall operate the Project, in Landlord's reasonable discretion, as a first class industrial/commercial real property development. Tenant shall pay Tenant's pro rata share (as defined below) of all costs incurred by Landlord in connection with the ownership, operation and maintenance of the Common Area ("Common Area Costs"). Common Area Costs include, but are not limited to, costs and expenses for the following: gardening and landscaping; pest control and extermination services; utilities, water and sewage charges; maintenance of signs (other than Tenant's signs); premiums for liability,

property damage, fire and other types of casualty insurance on the Common Areas and all Common Area improvements; all personal property taxes levied on or attributable to personal property used in connection with the Common Areas; straight-line depreciation on personal property owned by Landlord which is consumed in the operation or maintenance of the Common Areas; fees for required licenses and permits; repairing, resurfacing, repaving, maintaining, painting, lighting, cleaning, refuse removal, security and similar items; reserves; and a reasonable allowance to Landlord for Landlord's supervision of the Common Areas (not to exceed five percent (5%) of the total of all other Common Area Costs for the calendar year). Landlord may cause any or all of such services to be provided by third parties, or by entities associated with Landlord. Common Area Costs shall not include depreciation of real property which forms part of the Common Area, all Real Property Taxes for which Tenant is liable under this Sublease, all insurance premiums for which Tenant is liable under this Sublease, and all maintenance and repair costs for which Tenant is liable under this Sublease.

4.5.5 TENANT'S SHARE AND PAYMENT. Tenant shall pay Tenant's annual pro rata share of all estimated Common Area Costs, in advance, in monthly installments on the first day of each month during the Sublease Term (prorated for any fractional month). Tenant's pro rata share shall be calculated by dividing the square foot area of the Premises, as set forth in Section 1.4 of this Sublease, by the aggregate square foot area of the leasable area within the Project whether currently leased or not upon the date the computation is made. Landlord may adjust such estimates at any time and from time to time based upon Landlord's experience and reasonable anticipation of costs. Such adjustments shall be effective as of the next Rent payment date after notice to Tenant. Within thirty (30) days after the end of each calendar year of the Sublease Term, Landlord shall deliver to Tenant a statement prepared in accordance with generally accepted accounting principles setting forth, in reasonable detail, the actual Common Area Costs paid or incurred by Landlord during the preceding calendar year and Tenant's pro rata share. Upon receipt of such statement, there shall be an adjustment between Landlord and Tenant with payment to or credit given by Landlord (as the case may be) so that Landlord shall receive the entire amount of Tenant's share of such costs and expenses for such period. Any delay or failure of Landlord to deliver such statement within said thirty (30) day period will not constitute a waiver of Landlord's right to subsequently deliver such statement and require Tenant to pay any deficiency in Tenant's pro rata share as may be disclosed by such statement. Tenant shall have the right to audit the Common Area Costs billed to Tenant by Landlord. The cost of the audit shall be the responsibility of and paid by Tenant, unless the Common Area Costs billed to Tenant by Landlord exceed actual costs as verified by the audit by more than five (5) percent, in which case the cost of the audit shall be paid by Landlord.

4.5.5.1 ALTERNATIVE PAYMENT. Notwithstanding the foregoing, Landlord has the right to notify Tenant on a monthly or other basis of the actual amount Landlord has expended for all Common Area Costs incurred during the previous month or period. Such notice shall also set forth Tenant's pro rata share of such actual costs. Upon receipt of such statement, Tenant shall pay with the next monthly installment of Rent Tenant's pro rata share of the actual Common Area Costs incurred during the previous month or period.

4.5.6 ADDITIONAL AREAS. In addition to the Common Areas and costs associated therewith described in this Section 4.5, Landlord may, but is not obligated to, provide certain

additional spaces and areas within or in close proximity to the Project ("Additional Areas") as (and included within the definition of) Common Areas. The Additional Areas may include, but are not limited to, an office used by and subject to the exclusive control of Landlord for leasing and/or managing the Project, a conference room available on a reserved basis for use by tenants within the Project during normal business hours, maintenance facilities for the storage of equipment and supplies, and a locker room facility for use by tenants of the Project and their employees that are employed at the Project. Common Area Costs for which Tenant is liable for its pro rata share as described in Section 4.5.4 shall include costs of operating and the reasonable rental value of the space occupied by the Additional Areas. Notwithstanding anything to the contrary herein, Landlord agrees to make the conference Room Locker/shower facilities available to Tenant throughout the initial term of the sublease.

4.6 LATE CHARGES. Tenant's failure to pay Rent promptly may cause Landlord to incur unanticipated costs. The exact amount of such costs is impractical or extremely difficult to ascertain. Such costs may include, but are not limited to, processing and accounting charges and late charges which may be imposed on Landlord by any ground lease, mortgage or trust deed encumbering the Premises. Therefore, if Landlord does not receive any Rent payment within five (5) business days after it becomes due, Tenant shall pay Landlord a late charge equal to five percent (5%) of the overdue amount. The parties agree that such late charge represents a fair and reasonable estimate of the costs Landlord will incur by reason of such late payment.

4.6.1 REPEATED LATE CHARGES. In the event that a late charge is payable under this Sublease, whether or not collected, for four (4) installments of Base Rent during any one calendar year of the Sublease Term, then the Base Rent shall automatically become due and payable quarterly in advance, rather than monthly. All moneys paid to Landlord under this provision may be commingled with other moneys of Landlord and shall not bear interest.

4.7 INTEREST ON PAST DUE OBLIGATIONS. Any amount owed by Tenant to Landlord which is not paid when due shall bear interest at (i) the prime or reference rate, or succeeding similar index, announced by Bank of America (or its successor) from time to time plus four (4) percentage points or (ii) the highest rate then permitted by law, whichever is less, from the due date of such amount (the "Interest Rate"). However, interest shall not be payable on late chares to be paid by Tenant under this Sublease.

4.8 IMPOUNDS FOR INSURANCE PREMIUMS AND REAL PROPERTY TAXES. If requested by any ground lessor or lender to whom Landlord has granted a security interest in the Premises or the Project, or if Landlord deems it necessary in Landlord's sole and absolute discretion, of if Tenant is more than ten (10) business days late in the payment of Rent more than once in any consecutive twelve (12) month period, Tenant shall pay Landlord a sum equal to one-twelfth (1/12) of the annual Real Property Taxes and/or insurance premiums payable by Tenant under this Sublease (the "Impound Payments"), together with each payment of Base Rent. The Impound Payments shall be paid to the ground lessor or lender if required or held by Landlord with no obligation to pay Tenant interest thereon or keep the Impound Payments in a separate account. The amount of the Real Property Taxes and insurance premiums when unknown shall be reasonably estimated by Landlord. The Impound Payments shall be applied by Landlord to the payment of Real Property Taxes and insurance premiums when due. Any

deficiency of Impound Payments shall be paid by Tenant to Landlord upon written request. If Tenant defaults under this Sublease, Landlord may apply the Impound Payments to any obligation then due under this Sublease.

## ARTICLE V
## USEOF PREMISES

5.1 PERMITTED USES. Tenant may use the Premises only for the Permitted Uses set forth in Section 1.6 above.

5.2 MANNER OF USE.

5.2.1 OBJECTIONABLE USES. Tenant shall not do or permit anything to be done in or about the Premises which will in any way obstruct or interfere with or infringe on the rights of other occupants of the Project, or injure or annoy them, or use or allow the Premises to be used for any improper, immoral, or objectionable purposes; nor shall Tenant cause, maintain or permit any nuisance in, on or about the Premises or commit or suffer to be committed any waste in, on or about the Premises.

5.2.2 NONPERMITTED USES; COMPLIANCE WITH LAW. Tenant shall not do or permit to be done in or about the Premises, nor bring, keep or permit to be brought or kept therein, anything which is prohibited by or will in any way conflict with any law, statute, ordinance or governmental rule or regulation now in force or which may hereafter be enacted or promulgated, or which is prohibited by any standard form of fire insurance policy or will in any way increase the existing rate of or affect any fire or other insurance policy covering the Project or any part thereof or any of its contents. Tenant shall, at its sole expense, comply with all governmental laws, ordinances and regulations, with the requirements of any Board of Fire Underwriters or other similar body now or hereafter instituted, and with any order, directive or certificate of occupancy issued pursuant to any law, ordinance or regulation by any public officer, insofar as the same relates to or affects the condition, use or occupancy of the Premises; provided, however, Tenant will not be required to make any structural changes to the Premises unless such structural change is required due to Tenant's acts or particular occupancy or use of the Premises. The judgment of any court of competent jurisdiction or the admission of Tenant in any action against Landlord, whether or not Tenant is a party to such action, shall be conclusive in establishing such violations between Landlord and Tenant.

5.2.3 NOXIOUS ODORS. Tenant shall not use, keep or permit to be used or kept any foul or noxious gas or substance in the Premises, or permit or suffer the Premises to be occupied or used in a manner offensive or objectionable to Landlord or other occupants of the Project by reason of noise, odors and/or vibrations, or interfere in any way with other tenants or those having business therein, nor shall any animals or birds be brought in or kept in or about the Premises or the Project. Tenant shall not conduct any auction on the Premises. No cooking (with the exception of coffee, tea, cocoa, instant soups and microwavable foods) shall be done or permitted by Tenant on the Premises, nor shall the Premises be used for washing clothes, for lodging, or for any improper, objectionable or immoral purposes. Tenant shall not use or keep in

the Premises or the Project any kerosene, gasoline or inflammable or combustible fluid or material (except for small amounts of normal cleaning supplies used in day-to-day operations) or use any method of heating or air conditioning other than that supplied by Landlord.

5.2.4 PERMIT. Tenant shall obtain, pay for and keep current all permits required for Tenant's occupancy of the Premises and shall promptly take all actions necessary to comply with all applicable, statutes, ordinances, rules, regulations, orders and requirements regulating the use by Tenant of the Premises, including, without limitation, the Occupational Health and Safety Act and the Americans With Disabilities Act.

5.3 SIGNS AND AUCTIONS.

5.3.1 AUCTION. Tenant shall not conduct, or permit to be conducted, any sale by auction on the Premises.

5.3.2 PROHIBITED SIGNS. Tenant shall not place, or suffer to be placed or maintained, on any exterior door, wall or window of the Premises any sign, awning or canopy, or advertising matter or other thing of any kind, and will not place or maintain any decoration, lettering or advertising matter on the glass of any window or door, or that can be seen through the glass, of the Premises without Landlord's prior written approval. Tenant further agrees to maintain such sign, awning, canopy, decoration, lettering, advertising matter or things as may be approved, in good condition and repair at all times.

5.3.3 SIGN CRITERIA. Unless Tenant and Landlord agree otherwise, Landlord will install, at Tenant's expense, a sign for Tenant in the Project in accordance with the criteria described on Exhibit "C" attached hereto and by this reference incorporated herein.

5.4 HAZARDOUS MATERIALS.

5.4.1 PROHIBITION OF STORAGE; INDEMNITY. Tenant shall not cause or permit any Hazardous Material (as hereinafter defined) to be brought upon, kept or used in or about the Premises or the Project in violation of this sublease or any applicable laws by Tenant, its agents, employees, contractors or invitees, other than those expressly permitted by Landlord in writing. If Tenant breaches the obligation stated in the preceding sentence, or if the presence of Hazardous Materials on the Premises caused or permitted by Tenant (including Hazardous Materials specifically permitted by Landlord) results in contamination of the Premises or the Project, or if contamination of the Premises or the Project by Hazardous Material otherwise occurs for which Tenant is legally liable to Landlord for damage resulting therefrom, Tenant shall indemnify, defend and hold the Landlord Entities harmless from and against any and all claims, judgments, damages, penalties, fines, costs, liabilities, or losses (including without limitation diminution in value of the Premises or any portion of the Project, damages for the loss or restriction on use of rentable or usable space or of any amenity of the Premises of the Project, damages arising from any adverse impact on marketing of space in the Premises or the Project due to Tenant's breach of its obligations under the first sentence herein, and sums paid in settlement of claims, attorneys' fees, consultant fees and expert fees) which arise during or after the Sublease Term as a result of such contamination. This indemnification of the Landlord

Entities by Tenant includes, without limitation, costs incurred in connection with any investigation of site conditions or any cleanup, remedial, removal, or restoration work required by any federal, state or local governmental agency or political subdivision because of Hazardous Material present in the soil or ground water on or under the Premises. Without limiting the foregoing, if the presence of any Hazardous Material on the Premises caused or permitted by Tenant results in any contamination of the Premises or the Project, Tenant shall promptly take all actions at its sole expense as are necessary to return the Premises or the Project, as applicable, to the condition existing prior to the introduction of any such Hazardous Material to the Premises or the Project, as applicable, provided that Landlord's approval of such action shall first be obtained, which approval shall not be unreasonably withheld so long as such actions would not potentially have any material adverse long-term or short-term effect on the Premises or the Project.

5.4.2 TERMINATION OF LEASE. Deleted.

5.4.3 TESTING. At any time prior to the expiration of the Sublease Term, Landlord shall have the right, upon at least twenty-four (24) hours' advance notification, to conduct at Landlord's expense (subject to reimbursement as provided below) appropriate tests of water and soil and to deliver to Tenant the results of such tests to demonstrate that contamination has occurred as a result of Tenant's use of the Premises, provided, however, that Landlord shall not unreasonably interfere with Tenant's business operations. If the results of such tests demonstrate that contamination has occurred as a result of Tenant's use of the Premises, Tenant shall reimburse Landlord for the cost of such tests within ten (10) days following written demand therefor.

5.4.4 UNDERGROUND TANKS. If underground or other storage tanks storing Hazardous Materials are located on the Premises or are hereafter placed on the Premises by any party, Tenant shall monitor the storage tanks, maintain appropriate records, implement reporting procedures, properly close any underground storage tanks, and take or cause to be taken all other steps necessary or required under the California Administrative Code, Title 23, Chapter 3, Subchapter 16, "Underground Storage Tank Regulations," and Division 20, Chapter 6.7 of the California Health & Safety Code, "Underground Storage of Substances," as they now exist or may hereafter be adopted or amended.

5.4.5 TENANT'S OBLIGATIONS. Tenant's obligations under this Section 5.4 shall survive the termination of this Sublease. During any period of time employed by Tenant after the termination of this Sublease to complete the removal from the Premises of any such Hazardous Materials, the provisions of Section 2.5 shall apply. To the best of Landlord's knowledge, the Premises and the Project contain no Hazardous Materials as of the commencement date of this sublease.

5.4.6 DEFINITION OF "HAZARDOUS MATERIAL". As used herein, the term "Hazardous Material" means any hazardous or toxic substance, material or waste which is or becomes regulated by any local governmental authority, the State of California, the United States Government or any agency thereof. The term "Hazardous Material" includes, without limitation, any material or substance which is (i) defined as a "hazardous waste," "extremely hazardous waste" or "restricted hazardous waste" under Section 25115, 25117 or 25122.7, or listed pursuant

to Section 25140, of the California Health and Safety Code, Division 20, Chapter 6.5 (Hazardous Waste Control Law), (ii) defined as a "hazardous substance" or under Section 25316 of the California Health and Safety Code, Division 2, Chapter 6.8 (Carpenter-Presley-Tanner Hazardous Substance Account Act), (iii) defined as a "hazardous material," "hazardous substance" or "hazardous waste" under Section 25501 of the California Health and Safety Code, Division 20, Chapter 6.95 (Hazardous Substances), (v) petroleum, (vi) asbestos, (vii) listed under Article 9 and defined as hazardous or extremely hazardous pursuant to Article 11 of Title 22 of the California Administrative Code, Division 4, Chapter 20, (viii) designated as a "hazardous substance" pursuant to Section 311 of the Federal Water Pollution Control Act (33 U.S.C. Section 1317), (ix) defined as a "hazardous waste" pursuant to Section 1004 of the Federal Resource Conservation and Recovery Act, 42 U.S.C. Section 6091 et seq. (42 U.S.C. Section 6903), or (x) defined as a "hazardous substance" pursuant to Section 101 of the Comprehensive Environmental Response Compensation and Liability Act, 42 U.S.C. Section 9601 et seq. (42 U.S.C. Section 9601).

5.5 INDEMNIFICATION. None of the Landlord Entities shall be liable and Tenant hereby waives all claims against them for any damage to any property or any injury to any person in or about the Premises or the Project by or from any cause whatsoever (including without limiting the foregoing, rain or water leakage of any character from the roof, windows, walls, basement, pipes, plumbing works or appliances, the Project, or any portion thereof, not being in good condition or repair, gas, fire, oil, electricity, theft or the presence of Hazardous Material), except to the extent caused by or arising from the negligence or willful misconduct of Landlord or its agents, employees or contractors, or failure of Landlord to make repairs after receipt of notice of defects from Tenant, and then only to the extent such damage or injury is of a type not insured against, or required to be insured against hereunder, by Tenant. Tenant shall protect, indemnify, and hold the Landlord Entities harmless from and against any and all loss, claims, liability or costs (including court costs and attorney's fees) incurred by reason of (a) any damage to any property (including but not limited to property of any Landlord Entity) or any injury (including but not limited to death) to any person occurring in, on or about the Premises or the Project to the extent that such injury or damage shall be caused by or arise from any actual or alleged act, neglect or fault by Tenant, its agents, servants, employees, invitees or visitors, or from any omission by or of Tenant, its agents, servants, employees, invitees or visitors to meet any standards imposed by any duty with respect to the injury or damage; (b) the conduct or management of any work or thing whatsoever done by the Tenant in or about the Premises or from transactions of the Tenant concerning the Premises; (c) Tenant's failure to comply with any and all governmental laws, ordinances, and regulations applicable to the condition or use of the Premises or its occupancy; or (d) any breach or default on the part of Tenant in the performance of any covenant or agreement on the part of the Tenant to be performed pursuant to this Sublease. The provisions of this Section shall survive the termination of this Sublease with respect to any claims or liability accruing prior to such termination.

5.6 LANDLORD'S ACCESS. Landlord or its agents may enter the Premises during normal business hours to show the Premises to potential buyers, investors or tenants or other parties, or for any other purpose, Landlord reasonably deems necessary. Landlord shall give Tenant reasonable prior notice of such entry, except in the case of an emergency. Notwithstanding the

foregoing, Landlord shall not unreasonably interfere with Tenant's business operations, Landlord may place customary "For Sale" or "For Lease" signs on the Premises.

5.7 QUIET POSSESSION. If Tenant pays the rent and complies with all other terms of this Sublease, Tenant may occupy and enjoy the Premises for the full Sublease Term, subject to the provisions of this Sublease, free from hindrance by anyone claiming by, through or under Landlord.

5.8 WINDOW COVERING. Tenant shall not change the window coverings in the Premises without Landlord's prior written consent.

ARTICLE VI
CONDITION OF PREMISES;
MAINTENANCE, REPAIRS, AND ALTERATIONS

6.1 EXISTING CONDITIONS. Tenant accepts the Premises in its condition as of the execution of this Sublease, subject to any other provisions of this Sublease and to all recorded matters, laws, ordinances, and governmental regulations and orders. Tenant acknowledges that neither Landlord nor any agent of Landlord has made any representation as to the condition of the Premises or the suitability of the Premises for Tenant's intended use.

6.2 EXEMPTION OF LANDLORD FROM LIABILITY; WAIVER. Landlord shall not be liable for any damage or injury to the person, business (or any loss of income therefrom), goods, wares, merchandise or other property of Tenant, Tenant's employees, invitees, customers or any other persons in or about the Premises, whether such damage or injury is caused by or results from: (a) fire, steam, electricity, water, gas or rain; (b) the breakage, leakage, obstruction or other defects of pipes, sprinklers, wires, appliances, plumbing, air conditioning or lighting fixtures or any other cause; (c) conditions (including the presence of Hazardous Material) arising in or about the Premises or upon other portions of the Project, or from other sources or places; or (d) any act or omission of any other tenant of the Project. Landlord shall not be liable for any such damage or injury even though the cause of or the means of repairing such damage or injury are not accessible to Tenant. Tenant, as a material part of the consideration to be rendered to Landlord, hereby waives all claims against Landlord for the foregoing damages from any cause arising at any time. The provisions of this Section 6.2 shall not, however, except Landlord from liability for Landlord's negligence or willful misconduct, or for Landlord's failure to observe any of the terms and conditions of this Sublease.

6.3 TENANT'S OBLIGATIONS.

6.3.1 MAINTENANCE AND REPAIR. Tenant shall keep the Premises (including all nonstructural, interior and exterior areas, systems and equipment, all glass, glazing, window moldings, partitions, doors, door hardware, interior painting, fixtures, and appurtenances thereof (including electrical, lighting, plumbing, and plumbing fixtures) in good order, condition, and repair during the Sublease Term. Tenant shall promptly replace any portion of the Premises or system or equipment in the Premises which cannot be fully repaired, regardless of whether the

benefit of such replacement extends beyond the Sublease Term. Tenant shall also maintain a preventive maintenance contract providing for the regular inspection and maintenance of the heating and air conditioning system (including leaks around ducts, pipes, vents, or other parts of the air conditioning) by a licensed heating and air conditioning contractor. However, Landlord shall have the right, upon written notice to Tenant, to undertake the responsibility for preventive maintenance of the heating and air conditioning system, at Tenant's expense. It is the intention of the Landlord and Tenant that, at all times during the Sublease Term, Tenant shall maintain the Premises in an attractive, first-class fully operative condition. Further, Tenant shall keep the exterior areas surrounding the Premises free from litter and debris. Tenant waives and releases its rights under California Civil Code Section 1942.

6.3.2 TENANT EXPENSE. All of Tenant's obligations under Section 6.3.1 shall be accomplished at Tenant's sole expense. If Tenant refuses or neglects to properly perform its obligations as required under Section 6.3.1 and to the reasonable satisfaction of Landlord, Landlord may, on ten (10) days' prior written notice (except that no notice shall be required in case of emergency) enter the Premises and perform such obligation on behalf of Tenant without liability to Tenant for any loss or damage that may accrue to Tenant's merchandise, fixtures, or other property or to Tenant's business by reason thereof, and upon completion thereof, Tenant shall pay Landlord's costs for making such repairs plus fifteen percent (15%) for overhead, upon presentation of bill therefor, as Additional Rent. Said bill shall include interest at the Interest Rate on said costs from the date of completion of repairs by Landlord.

6.4 LANDLORD'S OBLIGATIONS. Landlord shall be responsible only for the maintenance and repair of structural portions of the Premises. As used herein, structural portions of the Premises shall only refer to the foundation and slabs, exterior walls, and exterior roof of the Building in which the Premises are located. If Landlord is required to make repairs to structural portions by reason of Tenant's conduct or activities, Landlord may add the cost of such repairs to the Rent which shall thereafter become due. Except for the cost of repairs subject to reimbursement pursuant to the preceding sentence, Tenant shall pay its pro rata share, computed in accordance with Subsection 4.2.1 hereof, of all repairs, alterations and improvements made by Landlord to the structural portions of the Building where the Premises are located. All such amounts shall be due and payable upon five (5) business days written notice from Landlord.

6.5 ALTERATIONS, ADDITIONS, AND IMPROVEMENTS.

6.5.1 PROHIBITED ACTIONS. Tenant shall not make any alterations, additions or improvements to the Premises without Landlord's prior written consent, except for nonstructural alterations which do not exceed Five Thousand Dollars ($5,000) in cost per alteration, and which are not visible from the outside of the Premises. In no event may Tenant install any antennas, satellite dishes or other devices on the roof of the Premises without Landlord's prior written consent, which consent Landlord may withhold in its sole and absolute discretion, Landlord may require Tenant to provide demolition and/or lien and completion bonds in form and amount satisfactory to Landlord. Tenant shall promptly remove any alterations, additions, or improvements constructed in violation of this Subsection 6.5.1 upon Landlord's written request. All alterations, additions, and improvements will be accomplished in good and workmanlike manner, in conformity with all applicable laws and regulations, and by a contractor approved by

Landlord. Upon completion of any such work, Tenant shall provide Landlord with "as built" plans (or dimensioned drawings of sufficient detail to reflect the alterations made by Tenant), copies of all construction contracts, and proof of payment for all labor and materials. Any additions to, or alterations of, the Premises, except moveable furniture and trade fixtures, shall become at once a part of the Premises and belong to Landlord; provided, however, (i) Landlord shall not be obligated to insure or restore such additions or alterations pursuant to Subsections 4.4.2 and 7.3, respectively, and (ii) to the extent an alteration or addition requires Landlord's consent hereunder and Tenant has failed to obtain such consent, Landlord may require Tenant to remove any such additions to, or alterations of, the Premises by giving Tenant written notice thereof prior to the termination of this Sublease in which event Tenant shall remove the same and repair any damage to the Premises caused by such removal. Nothing in this Section 6.5.1 shall prevent Tenant from installing trade fixtures, machinery or other trade equipment in conformance to all applicable laws and regulations, and the same may be removed upon the termination of this Sublease, provided the Premises are not damaged by such removal, and provided further that Tenant shall not then be in default under the terms and conditions of this Sublease.

6.5.2 PAYMENT BY TENANT. Tenant shall pay when due all claims for labor and material furnished to the Premises.

6.5.3 FREEDOM FROM LIENS. Tenant shall keep the Premises, all other property therein and the Project free from any liens arising out of any work performed, material furnished or obligations incurred by Tenant, and shall indemnify, hold harmless and defend the Landlord Entities from and against any liens and encumbrances arising out of any work performed or materials furnished by or at the direction of Tenant. In the event that Tenant shall not, within twenty (20) days following the imposition of any such lien, cause such lien to be released of record by payment or posting of a proper bond, Landlord shall have, in addition to all other remedies provided herein and by law, the right, but no obligation, to cause the same to be released by such means as it shall deem proper, including payment of the claim giving rise to such lien. All such sums paid by Landlord and all expenses incurred by it in connection therewith, including attorneys' fees and costs, shall be payable to Landlord by Tenant on demand with interest at the Interest Rate.

6.5.4 WRITTEN NOTIFICATION REQUIRED. Tenant will notify Landlord in writing ten (10) days prior to commencing any alterations or additions to allow Landlord time to file and post notices of nonresponsibility. Landlord reserves the right to approve any contractor and method of Payment, prior to said contractor making any improvements to the Premises.

6.6 RULES AND REGULATIONS.

Tenant agrees as follows:

(1) Landlord shall arrange for a trash collection service which will provide and periodically empty trash containers placed in designated areas for use by Tenant and other tenants in the Project. Tenant shall be responsible for placing all of its garbage and trash in such trash containers, and Tenant shall not permit any of its garbage or trash to accumulate outside of such trash containers.

(2) No aerial shall be erected on the roof or exterior walls of the Premises, or on the grounds, without in each instance, the written consent of the Landlord. Any aerial so installed without such written consent shall be subject to removal without notice at any time.

(3) No loudspeakers, televisions, phonographs, radios, or other devices shall be used in a manner so as to be heard or seen outside of the Premises without the prior written consent of Landlord.

(4) The outside areas immediately adjoining the Premises shall be kept clean and free from dirt and rubbish by Tenant to the satisfaction of Landlord, and Tenant shall not place or permit any obstruction or materials in such areas. No exterior storage shall be allowed without permission in writing from Landlord.

(5) The plumbing facilities shall not be used for any other purpose than that for which they are constructed, and no foreign substance of any kind shall be thrown therein, and the expense of any breakage, stoppage, or damage resulting from a violation of this provision shall be borne by Tenant.

(6) Tenant shall not burn any trash or garbage of any kind in or about the Premises, or the Project.

(7) The sidewalks, halls, passages, exits, entrances, and stairways in and about the Project shall not be obstructed by Tenant or used for any purpose other than for ingress to and egress from the Premises. The halls, passages, exits, entrances, stairways, balconies and roof are not for the use of the general public and Landlord shall in all cases retain the right to control and prevent access thereto by all persons whose presence in the judgment of the Landlord shall be prejudicial to the safety, character, reputation and interests of the Project, provided that nothing herein contained shall be constructed to prevent such access to persons with whom Tenant normally deals in the ordinary course of Tenant's business unless such persons are engaged in illegal activities. Tenant and its employees and invitees shall not go upon the roof of the Building.

(8) No additional locks or bolts of any kind shall be placed upon any of the doors or windows by Tenant, nor shall any changes be made in existing locks or the mechanisms thereof. Tenant must, upon the termination of Tenant's tenancy, return to Landlord all keys of stores, offices and toilet rooms either furnished to or otherwise procured by Tenant, and in the event of the loss of any keys so furnished Tenant shall pay to Landlord the cost thereof.

(9) Tenant shall not lay linoleum or other similar floor covering so that the same shall be affixed to the floor of the Premises in any manner except by a paste, or other material, which may easily be removed with water, the use of cement or other similar adhesive materials being expressly prohibited. The method of affixing any such linoleum or other similar floor covering to the floor, as well as the method of affixing carpets or rugs to the Premises, shall

be subject to approval by Landlord. The expense of repairing any damage resulting from a violation of this rule shall be borne by Tenant.

(10) Tenant will not install blinds, shades, awnings, or other form of inside or outside window covering, or window ventilators or similar devices, without the prior written consent of Landlord.

Landlord reserves the right from time to time to reasonably amend or supplement the foregoing rules and regulations, and to adopt and promulgate additional reasonable rules and regulations applicable to the Premises. Notice of such rules and regulations and amendments and supplements thereto, if any, shall be given to the Tenant and Tenant agrees to comply with all such rules and regulations upon receipt of notice to Tenant from Landlord. Landlord shall not be liable in any way to Tenant for any damage or inconvenience caused by any other tenant's noncompliance with these rules and regulations; Landlord shall, however, use its best commercially reasonable efforts to cause such compliance.

6.7 CONDITION UPON TERMINATION. Upon the termination of the Sublease, Tenant shall surrender the Premises to Landlord, broom-clean and in the same condition as received except for ordinary wear and tear which Tenant was not otherwise obligated to remedy under any provision of this Sublease. However, Tenant shall not be obligated to repair any damage which Landlord is required to repair under Article Seven (Damage or Destruction). In addition, and in accordance with Section 6.5.1, Landlord may require Tenant to remove any alterations, additions or improvements (where Landlord's consent is required but not obtained, or if at the time approval is granted Landlord advises Tenant in writing that removal of the alterations, additions or improvements may be required) prior to the termination of this Sublease. Any alterations, additions or improvements which Landlord has not required Tenant to remove shall become Landlord's property and shall be surrendered to Landlord upon the termination of the Sublease, except that Tenant may remove any of Tenant's machinery or equipment which can be removed without material damage to the Premises. Tenant shall repair, at Tenant's expense, any damage to the Premises caused by the removal of any such machinery or equipment. In no event, however, shall Tenant remove any of the following materials or equipment without Landlord's prior written consent: any power wiring or power panels; lighting or lighting fixtures; wall coverings; drapes, blinds or other window coverings; carpets or other floor coverings; heaters, air conditioners or any other heating or air conditioning equipment; fencing or security gates; or other similar building operating equipment and decorations.

6.8 MAINTENANCE OF COMMON AREAS. Landlord shall maintain the Common Areas as set forth in Section 4.5 above.

## ARTICLE VII
## DAMAGE OR DESTRUCTION

7.1 PARTIAL DAMAGE TO PREMISES. Tenant shall notify Landlord in writing immediately upon the occurrence of any damage to the Premises. If the Premises are only partially damaged and if the proceeds received by Landlord from the insurance policies described

in Subsection 4.4.2 are sufficient to pay for the necessary repairs, this Sublease shall remain in effect and Landlord shall repair the damage as soon as reasonably possible; provided, however, that if Landlord either (i) fails to commence such repairs within thirty (30) days, or (ii) fails to complete such repairs within 270 days, and further provided that such damage materially interferes with Tenant's business operations, Tenant may elect to terminate this sublease. Landlord may elect, with Tenant's consent, to repair any damage to Tenant's equipment, fixtures or improvements installed in the Premises at Tenant's sole cost and expense. If the insurance proceeds received by Landlord are not sufficient to pay the entire cost of repair, or if the cause of the damage is not covered by the insurance policies which Landlord maintains under Subsection 4.4.2, Landlord may elect either to (a) repair the damage as soon as reasonably possible, in which case this Sublease shall remain in full force and effect, or (b) terminate this Sublease as of the date the damage occurred. Landlord shall notify Tenant within thirty (30) days after receipt of notice of the occurrence of the damage whether Landlord elects to repair the damage or terminate this Sublease. Tenant shall pay to Landlord within thirty (30) days after request therefor by Landlord the "deductible amount" (if any) under Landlord's insurance policies if the damage was due to an act or omission of Tenant. If the damage to the Premises occurs during the last twelve (12) months of the Sublease Term, Landlord or Tenant may elect to terminate this Sublease as of the date the damage occurred, regardless of the sufficiency of any insurance proceeds, and Landlord may retain all such proceeds. In such event, Landlord shall not be obligated to repair or restore the Premises, and the other party shall have no right to continue this sublease. The notifying party shall notify the other party of its election within thirty (30) business days after receipt of notice of the occurrence of the damage.

7.2 TOTAL OR SUBSTANTIAL DESTRUCTION. If the Premises are totally or substantially destroyed (meaning the cost to repair would exceed twenty-five percent (25%) of replacement value) by any cause whatsoever, or if the Premises are in a building which is substantially destroyed (even though the Premises are not totally or substantially destroyed), or if the Project is substantially destroyed (even though the Premises are not totally or substantially destroyed), this Sublease shall, at the election of either Landlord or Tenant, terminate as of the date the destruction occurred regardless of whether Landlord receives any insurance proceeds. The notifying party shall notify the other party of such election within thirty (30) business days after the occurrence of total or substantial destruction. If the destruction was caused by an act or omission of Tenant, Tenant shall pay Landlord the difference between the actual cost of rebuilding and any insurance proceeds received by Landlord.

7.3 LANDLORD'S OBLIGATIONS. Landlord shall promptly commence and diligently pursue to completion any repairs which it is obligated to effect under Section 7.1. Landlord shall not be required to repair any injury or damage by fire or other cause to (or to make any restoration or replacement of) any paneling, decorations, partitions, railings, floor coverings, office fixtures or any other improvements of property installed in the Premises by Tenant or at the direct or indirect expense of Tenant which are not part of the original Tenant improvements paid for by Landlord. Tenant shall be required to restore or replace same in the event of damage except for damage caused solely by the Landlord's gross negligence or intentional misconduct that is not covered by the insurance carried, or required to be carried hereunder, by Tenant. Tenant shall have no claim against Landlord for any damage suffered by reason of any such

damage, destruction, repair or restoration, except to the extent caused by Landlord's negligence or willful misconduct.

7.4 TEMPORARY REDUCTION OF RENT. If the Premises are destroyed or damaged and Landlord or Tenant repairs or restores the Premises pursuant to the provisions of this Article Seven, any Base Rent payable during the period of such damage, repair and/or restoration shall be reduced in proportion to the rentable space which is unusable by Tenant in the conduct of its business, but only to the extent that Landlord has obtained rental income insurance to cover such abatement of Base Rent. Except for such possible reduction in payments required from Tenant, Tenant shall not be entitled to any compensation, reduction, or reimbursement from Landlord as a result of any damage, destruction, repair or restoration of or to the Premises.

7.5 WAIVER. Tenant waives the provisions of any statute, code or judicial decision which grants a tenant the right to terminate a lease in the event of damage or destruction of its premises, including Sections 1932(2) and 1933(4) of the California Civil Code, due to the fact that Tenant agrees that the provisions of this Article Seven shall govern the rights and obligations of Landlord and Tenant in the event of any damage or destruction of the Premises.

## ARTICLE VIII
## CONDEMNATION

8.1 CONDEMNATION. If all or any portion of the Premises is taken under the power of eminent domain or sold under the threat of that power (all of which are called "Condemnation"), this Sublease shall terminate as to the part taken or sold on the date the condemning authority takes title or possession, whichever occurs first. If more than twenty percent (20%) of the floor area of the Premises or more than twenty percent (20%) of the parking spaces available to Tenant under Section 4.5.3 are taken and Landlord is unable to provide reasonable substitute parking, either Landlord or Tenant may terminate this Sublease as of the date the condemning authority takes title or possession, whichever occurs first, by delivering written notice to the other within ten (10) days after receipt of written notice of such taking (or in the absence of such notice, within ten (10) days after the condemning authority takes possession). If more than twenty percent (20%) of all subleasable space in the Building in which the Premises are located or more than fifty percent (50%) of all subleasable space within the Project is taken Landlord may elect to terminate this Sublease by delivering such notice to Tenant. If neither Landlord nor Tenant terminates this Sublease, this Sublease shall remain in effect as to the portion of the Premises not taken, except that the Base Rent shall be reduced in proportion to the reduction in the floor area of the Premises. Any Condemnation award or payment shall be distributed in the following order: (a) first, to any ground lessor, mortgagee or beneficiary under a deed of trust encumbering the Premises, the amount of its interest in the Premises and Tenant hereby assigns any other rights which Tenant may have now or in the future to any other award to Landlord; (b) second, to Tenant, only the amount of any award specifically designated for loss of or damage to Tenant's trade fixtures or removable personal property, and Tenant hereby assigns any other rights which Tenant may have now or in the future to any other award to the Landlord, and (c) third, to Landlord; the remainder of such award, whether as compensation for reduction in the value of the subleasehold, the taking of the fee, or otherwise. If this Sublease is not terminated, Landlord

shall repair any damage to the Premises caused by the Condemnation, except that Landlord shall not be obligated to repair any damage for which Tenant has been reimbursed by the condemning authority. If the severance damages received by Landlord are not sufficient to pay for such repair, Landlord shall have the right to either terminate this Sublease or make such repair at Landlord's expense.

8.2 WAIVER. Tenant waives the provisions of any statute, code or judicial decision which grants a tenant the right to terminate a lease in the event of a taking of its premises, including California Code of Civil Procedure Section 1265.130, due to the fact that Tenant agrees that the provisions of this Article Eight shall govern the rights and obligations of Landlord and Tenant in the event of a taking of the Premises.

## ARTICLE IX
## ASSIGNMENT AND SUBLETTING

9.1 LANDLORD'S CONSENT REQUIRED. No portion of the Premises or of Tenant's interest in this Sublease may be acquired by any other person or entity, whether by assignment, mortgage, sublease, transfer, operation of law, or act of Tenant, without Landlord's prior written consent, except as provided in Section 9.2 below. Any attempted transfer without consent shall, at Landlord's option, be void and shall constitute a noncurable breach of this Sublease. Except as otherwise provided in Section 9.2, if Tenant is a partnership, limited liability company or corporation, any cumulative transfer of more than fifty percent (50%) of the ownership interest in Tenant shall be deemed an assignment of this Sublease requiring Landlord's consent. If Tenant effects a transfer or requests the consent of Landlord to any transfer (whether or not such transfer is consummated), then, upon demand, and as a condition precedent to Landlord's consideration of the proposed transfer, Tenant agrees to pay Landlord a non-refundable administrative fee of Two Hundred Dollars ($200.00), plus Landlord's reasonable attorneys' fees and costs and other costs incurred by Landlord in reviewing such proposed transfer.

9.2 TENANT AFFILIATE. Tenant may assign this Sublease or sublease the Premises, without Landlord's consent, to any entity which controls, is controlled by or is under common control with Tenant, or to any entity resulting from the merger of or consolidation with Tenant ("Tenant's Affiliate"). In such case, any Tenant's Affiliate shall assume in writing all of Tenant's obligations under this Sublease, but Tenant shall remain primarily liable hereunder.

9.3 NO RELEASE OF TENANT. No transfer permitted by this Article Nine, whether with or without Landlord's consent, shall release Tenant or change Tenant's primary liability to pay the Rent and to perform all other obligations of Tenant under this Sublease. Landlord's acceptance of Rent from any other person is not a waiver of any provision of this Article Nine. Consent to one transfer is not a consent to any subsequent transfer. If Tenant's transferee defaults under this Sublease, Landlord may proceed directly against Tenant without pursuing remedies against the transferee. Landlord may consent to subsequent assignments or modifications of this Sublease by Tenant's transferee, without notifying Tenant or obtaining its consent. Such action shall not relieve Tenant's liability under this Sublease.

9.4 LANDLORD'S ELECTION. Tenant's request for consent to any transfer described in Section 9.1 above shall be accompanied by a written statement setting forth the details of the proposed transfer, including the name, business and financial condition of the prospective transferee, financial details of the proposed transfer (e.g., the term of any rent and security deposit payable under any assignment or sublease), and any other information Landlord reasonably deems relevant. Landlord shall have the right (a) to withhold consent in Landlord's reasonable discretion; (b) to grant consent; or (c) if the transfer is a sublease of the Premises or an assignment of this Sublease, to terminate this Sublease as of the effective date of such sublease or assignment, in which case Landlord may elect to enter into a direct sublease with the proposed assignee or subtenant. By way of example and without limitation, the parties agree it shall be reasonable for Landlord to withhold its consent to a proposed transfer if any of the following situations exist or may exist: (i) the transferee's contemplated use of the Premises following the proposed transfer is different than the Permitted Uses set forth in Section 1.6 and is not an appropriate use for the Project, or in Landlord's opinion is not a use compatible with contemplated or existing uses within the Project; (ii) in Landlord's reasonable business judgment, the transferee lacks sufficient business reputation or experience to operate a successful business of the type and quality permitted under this Lease; (iii) in Landlord's reasonable business judgment, the present net worth of the transferee indicates a reasonable likelihood that such transferee will be unable to perform Tenant's obligations under this Sublease; or (iv) the proposed transfer would breach any covenant of Landlord respecting radius, location, use or exclusivity in any other lease, financing agreement, or other agreement to which Landlord is bound.

9.5 NO MERGER. No merger shall result from Tenant's sublease of the Premises under this Article Nine. Tenant's surrender of this Sublease or the termination of this Sublease in any other manner. In any such event, Landlord may terminate any or all subtenancies or succeed to the interest of Tenant as sublandlord thereunder.

9.6 EXCESS RENTALS. Tenant agrees to pay to Landlord, as additional rent, all sums and other consideration payable to and for the benefit of Tenant by the assignee or sublessee in excess of the rent payable under this Lease for the same period and portion of the Premises. In calculating excess rent or other consideration which may be payable to Landlord under this Section 9.6, Tenant will be entitled to deduct commercially reasonable third party brokerage commissions and attorneys' fees and other amounts reasonably and actually expended by Tenant in connection with such assignment or subletting if acceptable written evidence of such expenditures is provided to Landlord.

## ARTICLE X
## DEFAULTS; REMEDIES

10.1 COVENANTS AND CONDITIONS. Tenant's performance of each of Tenant's obligations under this Sublease is a condition as well as a covenant. Tenant's right to continue in possession of the Premises is conditioned upon such performance. Time is of the essence in the performance of all covenants and conditions.

10.2 DEFAULTS. Tenant shall be in material default under this Sublease:

10.2.1 VACATION OR ABANDONMENT. If Tenant abandons or vacates the Premises or if such abandonment or vacation of the Premises results in the cancellation of any insurance described in Section 4.4; or

10.2.2 FAILURE TO PAY. If Tenant fails to pay rent or any other charge required to be paid by Tenant, as and within five (5) business days of the date when due. The notice required by this Subsection is intended to satisfy any and all notice requirements imposed by California Code of Civil Procedure Section 1161, et seq. or any other applicable law and is not in addition to any such requirements; or

10.2.3 FAILURE TO PERFORM. If Tenant fails to perform any of Tenant's nonmonetary obligations under this Sublease for a period of thirty (30) days after written notice from Landlord; provided that if more time is required to complete such performance, Tenant shall not be in default if Tenant commences such performance within the thirty (30) day period and thereafter diligently pursues its completion. However, Landlord shall not be required to give such notice if Tenant's failure to perform constitutes a non-curable breach of this Sublease. The notice required by this Subsection is intended to satisfy any and all notice requirements imposed by California Code of Civil Procedure Section 1161, et seq. or any other applicable law and is not in addition to any such requirements. Notwithstanding the foregoing, Tenant shall be obligated to commence performance to cure matters related to the storage or use of hazardous materials within fifteen days of receipt of notice from Landlord.

10.2.4 OTHER DEFAULTS. (i) If Tenant makes a general assignment or general arrangement for the benefit of creditors; (ii) if a petition for adjudication of bankruptcy or for reorganization or rearrangement is filed by or against Tenant and is not dismissed within thirty (30) days; (iii) if a trustee or receiver is appointed to take possession of substantially all of Tenant's assets located at the Premises or of Tenant's interest in this Sublease and possession is not restored to Tenant within thirty (30) days; or (iv) if substantially all of Tenant's assets located at the Premises or of Tenant's interest in this Sublease is subjected to attachment, execution or other judicial seizure which is not discharged within thirty (30) days; or (iv) if substantially all of Tenant's assets located at the Premises or of Tenant's interest in this Sublease is subjected to attachment, execution or other judicial seizure which is not discharged within thirty (30) days. If a court of competent jurisdiction determines that any of the acts described in this Subsection 10.2.4 is not a default under this Sublease, and a trustee is appointed to take possession (or if Tenant remains a debtor in possession) and such trustee or Tenant transfers Tenant's interest hereunder, then Landlord shall receive, as Additional Rent, the difference between the Rent (or any other consideration) paid in connection with such assignment or sublease and the Rent payable by Tenant hereunder.

10.3 REMEDIES. On the occurrence of any material default by Tenant, Landlord may, at any time thereafter, with or without notice or demand and without limiting Landlord in the exercise of any right or remedy which Landlord may have:

10.3.1 TERMINATION OF POSSESSION. Terminate Tenant's right to possession of the Premises by any lawful means, in which case this Sublease shall terminate and Tenant shall immediately surrender possession of the Premises to Landlord. In such event Landlord shall have the immediate right to re-enter and remove all persons and property and such property may be removed and stored in a public warehouse or elsewhere at the cost of, and for the account of Tenant, all without service of notice or resort to legal process and without being deemed guilty of trespass, or becoming liable for any loss or damage which may be occasioned thereby, and Landlord shall be entitled to recover from Tenant all damages incurred by Landlord by reason of Tenant's default, including (i) the worth at the time of the award of all Base Rent, Additional Rent and other charges which were earned or were payable at the time of the termination; (ii) the worth at the time of the award of the amount by which the unpaid Base Rent, Additional Rent and other charges which would have been earned or were payable after termination until the time of the award exceeds the amount of such Rental loss that Tenant proves could have been reasonably avoided; (iii) the worth at the time of the award of the amount by which the unpaid Base Rent, Additional Rent and other charges which would have been payable for the balance of the Sublease Term after the time of award exceeds the amount of such Rental loss that Tenant proves could have been reasonably avoided; and (iv) any other amount necessary to compensate Landlord for all the detriment proximately caused by Tenant's failure to perform its obligations under this Sublease or which in the ordinary course of things would be likely to result therefrom, including, but not limited to, any costs or expenses incurred by Landlord in maintaining or preserving the Premises after such default, the cost of recovering possession of the Premises, expenses of reletting, including necessary renovation or alteration of the Premises, Landlord's reasonable attorneys' fees incurred in connection therewith, and any real estate commissions or other such fees paid or payable.

As used in subparts (i) and (ii) above, the "worth at the time of the award" is computed by allowing interest on unpaid amounts at the Interest Rate. As used in subpart (iii) above, the "worth at the time of the award" is computed by discounting such amount at the discount rate of the Federal Reserve Bank of San Francisco at the time of the award, plus one percent (1%). If Tenant shall have abandoned the Premises, Landlord shall have the option of (i) retaking possession of the Premises and recovering from Tenant the amount specified in this Subsection 10.3.1, or (ii) proceeding under Subsection 10.3.2.

10.3.2 MAINTENANCE OF POSSESSION. Maintain Tenant's right to possession, in which case this Sublease shall continue in effect whether or not Tenant shall have abandoned the Premises. In such event, Landlord shall be entitled to enforce all of Landlord's rights and remedies under this Sublease, including the right to recover the Rent as it becomes due hereunder as permitted by California Civil Code Section 1951.4 or any successor statute.

10.3.3 OTHER REMEDIES. Pursue any other remedy now or hereafter available to Landlord under the laws or judicial decisions of the State of California.

10.4 THE RIGHT TO RELET THE PREMISES. Should Landlord elect to re-enter, as herein provided, or should it take possession pursuant to legal proceedings or pursuant to any notice provided for by law, it may either terminate this Sublease or it may from time to time without terminating this Sublease, make such alterations and repairs as may be necessary in order

to relet the Premises, and relet the Premises or any part thereof for such term or terms (which may be for a term extending beyond the term of this Sublease) and at such rental or rentals and upon such other terms and conditions as Landlord in its sole discretion may deem advisable; upon each such reletting all rentals received by Landlord from such reletting shall be applied, first, to the repayment of any indebtedness other than Rent due hereunder from Tenant to Landlord; second, to the payment of any costs and expenses of such reletting, including brokerage fees and attorneys' fees and of costs of such alterations and repairs; third, to the payment of Rent due and unpaid hereunder, and the residue, if any, shall be held by Landlord and applied in payment of future Rent as the same may become due and payable hereunder. If such Rentals received from such reletting during any month are less than that to be paid during that month by Tenant hereunder, Tenant shall pay any such deficiency to Landlord. Such deficiency shall be calculated and paid monthly. No such re-entry or taking possession of the Premises by Landlord shall be construed as an election on its part to terminate this Sublease unless a written notice of such intention be given to Tenant or unless the termination thereof be decreed by a court of competent jurisdiction.

10.5 WAIVER OF RIGHTS OF REDEMPTION. Tenant hereby expressly waives any and all rights of redemption granted by or under any present or future laws in the event of Tenant being evicted or dispossessed for any cause, or in the event of Landlord obtaining possession of the Premises, by reason of the violation by Tenant of any of the covenants or conditions of this Sublease, or otherwise.

10.6 CUMULATIVE REMEDIES. Landlord's exercise of any right or remedy shall not prevent it from exercising any other right or remedy.

10.7 RIGHT TO CURE. If Tenant fails, refuses or neglects to perform any obligation under this Sublease in the time and manner required herein, Landlord shall have the right, but not the obligation, after ten (10) days prior written notice to Tenant, to do the same, but at the expense and for the account of Tenant. The amount of money so expended or obligations so incurred by Landlord, together with interest thereon at the Interest Rate, shall be repaid to Landlord as Additional Rent within five (5) days of Tenant's receipt of written notice thereof. Landlord's performance of such obligations shall not waive any default by Tenant hereunder.

## ARTICLE XI
## PROTECTION OF CREDITORS

11.1 SUBORDINATION. This Sublease is and shall remain subordinate to the Master Lease, and to any other ground lease, deed of trust or mortgage encumbering the Premises, any advances made on the security thereof and any renewals, modifications, consolidations, replacements or extensions thereof, whenever made or recorded. However, Landlord shall, within thirty (30) days after the Commencement Date with respect to any existing encumbrance (including the Master Lease), and prior to the effective date of any subordination to any future encumbrance, deliver to Tenant a non-disturbance agreement, in a commercially reasonable form, in which such ground lessor or the beneficiary or holder of such encumbrance shall agree to honor all of Tenant's rights and remedies under this Sublease. If any ground lessor, beneficiary or mortgagee

elects to have this Sublease prior to the lien of its ground lease, deed of trust or mortgage and gives written notice thereof to Tenant, this Sublease shall be deemed prior to such ground lease, deed of trust or mortgage whether this Sublease is dated prior or subsequent to the date of said ground lease, dead of trust or mortgage of the date of recording thereof.

11.2 ATTORNMENT. If Landlord's interest in the Premises is acquired by any ground lessor, beneficiary under a deed of trust, mortgagee, or purchaser at a foreclosure sale, Tenant shall attorn, to the transferee of or successor to Landlord's interest in the Premises and recognize such transferee or successor as Landlord under this Sublease, Tenant waives the protection of any statute or rule of law which gives or purports to give Tenant any right to terminate this Sublease or surrender possession of the Premises upon the transfer of Landlord's interest.

11.3 SIGNING OF DOCUMENTS. Tenant shall sign and deliver any commercially reasonable documents necessary or appropriate to evidence any such non-disturbance, attornment or subordination or agreement to do.

11.4 ESTOPPEL CERTIFICATES.

11.4.1 LANDLORD'S REQUEST. Upon Landlord's written request, Tenant shall execute, acknowledge and deliver to Landlord a written statement certifying: (i) that none of the terms or provisions of this Sublease have been changed (or if they have been changed, stating how they have been changed); (ii) that this Sublease has not been canceled or terminated; (iii) the last date of payment of the Base Rent and other charges and the time period covered by such payment; (iv) that Landlord is not in default under this Sublease (or, if the Landlord is claimed to be in default, stating why); and (v) as to such other matters as may be reasonably requested of Tenant. Tenant shall deliver such statement to Landlord within ten (10) days after Landlord's request. Any such statement by Tenant may be given by Landlord to any prospective purchaser or encumbrancer of the Premises, Such purchaser or encumbrancer may rely conclusively upon such statement as true and correct.

11.4.2 FAILURE TO DELIVER. If Tenant does not deliver such statement to Landlord within such ten (10) day period, Tenant shall be in material default under this Sublease and, in addition, Landlord, and any prospective purchaser or encumbrancer, may conclusively presume and rely upon the facts set forth in such Statement. In such event, Tenant shall be estopped from denying the truth of such facts.

11.5 TENANT'S FINANCIAL CONDITION. Tenant shall, upon ten (10) days prior written notice, provide Landlord with a financial statement for the prior year and, if available, the current year, to the extent such statements are then in existence, prepared in accordance with generally accepted accounting principles and, if such is Tenant's normal practice, audited by an independent certified public accountant.

## ARTICLE XII
## LEGAL COSTS

12.1 ATTORNEYS' FEES. If either party commences litigation against the other for the specific performance of this Sublease, for damages for the breach hereof or otherwise for enforcement of any remedy hereunder, in the event of any such commencement of litigation, the prevailing party shall be entitled to recover from the other party such costs and reasonable attorneys' fees as may have been incurred.

Further, if for any reason Landlord consults legal counsel or otherwise incurs any costs or expenses as a result of its rightful attempt to enforce the provisions of this Sublease after Tenant's grace or notice period has expired, after written notice to Tenant from Landlord that Landlord is seeking the advice of counsel, even though no litigation is commenced, or if commenced is not pursued to final judgment, Tenant shall be obligated to pay to Landlord, in addition to all other amounts for which Tenant is obligated hereunder, all of Landlord's costs, expenses and reasonable attorneys' fees incurred in connection with obtaining such advice.

12.2 LANDLORD'S CONSENT. Tenant shall pay Landlord's reasonable attorneys' fees (not to exceed $500 per occurrence) incurred in connection with Tenant's request for Landlord's consent under Article Nine (Assignment and Subletting), or in connection with any other act which Tenant proposes to do and which requires Landlord's consent.

## ARTICLE XIII
## MISCELLANEOUS PROVISIONS

13.1 SUBSTITUTED PREMISES. Deleted.

13.2 LANDLORD'S LIABILITY; CERTAIN DUTIES.

13.2.1 LANDLORD. As used in this Sublease, the term "Landlord" means only the current owner or owners of the leasehold estate under the Master Lease at the time in question. Each Landlord is obligated to perform the obligations of Landlord under this Sublease only during the time such Landlord owns such interest or title. Any Landlord who transfers its title or interest is relieved of all liability with respect to the obligations of Landlord under this Sublease to be performed on or after the date of transfer. However, each Landlord shall deliver to its transferee all funds previously paid by Tenant if such funds have not yet been applied under the terms of this Sublease. Notwithstanding the foregoing, for purposes of Tenant's indemnification obligations under this Sublease, the term "Landlord" shall include the current owner(s) of the leasehold estate under the Master Lease and all prior owner(s) thereof during the Sublease Term.

13.2.2 WRITTEN NOTICE. Tenant shall give written notice of any failure by Landlord to perform any of its obligations under this Sublease to Landlord and to the District, any ground lessor, mortgagee or beneficiary under any deed of trust encumbering the Premises whose name and address have been furnished to Tenant in writing. Landlord shall not be in default under this Sublease unless Landlord (or the District, or such ground lessor, mortgagee or

beneficiary) fails to cure such non-performance within thirty (30) days after receipt of Tenant's notice. However, if such non-performance reasonably requires more than thirty (30) days to cure, Landlord shall not be in default if such cure is commenced within such thirty (30) day period and thereafter diligently pursued to completion.

13.2.3 EXCULPATION. It is expressly understood and agreed that, notwithstanding anything in this Sublease to the contrary, and notwithstanding any applicable law to the contrary, the liability of Landlord hereunder and any recourse by Tenant against Landlord shall be limited solely and exclusively to the interest of Landlord in and to the Project, and neither Landlord, nor any of its constituent partners or subpartners, shall have any personal liability therefor, and Tenant, on behalf of itself and all persons claiming by, through or under Tenant, hereby expressly waives and releases Landlord and such partners and subpartners from any and all personal liability.

13.2.4 FAILURE TO GIVE CONSENT. Deleted.

13.3 SEVERABILITY. A determination by a court of competent jurisdiction that any provision of this Sublease or any part thereof is illegal or unenforceable shall not cancel or invalidate the remainder of such provision or this Sublease, which shall remain in full force and effect.

13.4 INTERPRETATION. The captions of the Articles or Sections of this Sublease are to assist parties in reading this Sublease and are not a part of the terms of provisions of this Sublease. Whenever required by the context of this Sublease, the singular shall include the plural and the plural shall include the singular. The masculine, feminine, and neuter genders shall each include the other. In any provision relating to the conduct, acts or omissions of Tenant, the term "Tenant" shall include Tenant's agents, employees, contractors, invitees, successors or others using the Premises with Tenant's expressed or implied permission.

13.5 INCORPORATION OF PRIOR AGREEMENTS; MODIFICATIONS. This Sublease is the only agreement between the parties pertaining to the sublease of the Premises and no other agreements are effective, All amendments to this Sublease shall be in writing and signed by all parties. Any other attempted amendment shall be void.

13.6 NOTICES. All notices required or permitted under this Sublease shall be in writing and shall be personally delivered or sent by certified mail, return receipt requested, postage prepaid. Notices to Tenant shall be delivered to the address specified in Section 13 above, except that upon Tenant's taking possession of the Premises, the Premises shall be Tenant's address for notice purposes. Notices to Landlord shall be delivered to the address specified in Section 1.2 above. If personally delivered, notice shall be effective upon personal delivery or refusal. If mailed as aforesaid, notice shall be effective upon delivery or refusal as evidenced by the return receipt. Either party may change its notice address upon written notice to the other party.

13.7 WAIVERS. All waivers must be in writing and signed by the waiving party. Landlord's failure to enforce any provision of this Sublease or its acceptance of rent shall not be a waiver and shall not prevent Landlord from enforcing that provision or any other provision of this

Sublease in the future. No statement on a payment check from Tenant or in a letter accompanying a payment check shall be binding on Landlord. Landlord may, with or without notice to Tenant, negotiate such check without being bound to the conditions of such statement.

13.8 NO RECORDATION. Tenant shall not record this Sublease without prior written consent from Landlord. However, Landlord may require that a "Short Form" memorandum of this Sublease be executed by both parties and recorded.

13.9 BINDING EFFECT; CHOICE OF LAW. This Sublease binds any party who legally acquires any rights or interest in this Sublease from Landlord or Tenant. However, Landlord shall have no obligation to Tenant's successor unless the rights or interests of Tenant's successor are acquired in accordance with the terms of this Sublease. The laws of the State of California shall govern this Sublease.

13.10 CORPORATE AUTHORITY; PARTNERSHIP AUTHORITY. If Tenant is a corporation, each person signing this Sublease on behalf of Tenant represents and warrants that he has full authority to do so and that this Sublease binds the corporation. As soon as is reasonably possible after this Sublease is signed, Tenant shall deliver to Landlord a certified copy of a resolution of Tenant's Board of Directors authorizing the execution of this Sublease or other evidence of such authority reasonably acceptable to Landlord. If Tenant is a partnership, each person signing this Sublease for Tenant represents and warrants that he is a general partner of the partnership, that he has full authority to sign for the partnership and that this Sublease binds the partnership and all general partners of the partnership. Tenant shall give written notice to Landlord of any general partner's withdrawal or addition. Within five (5) days after this Sublease is signed, Tenant shall deliver to Landlord a copy of Tenant's recorded statement of partnership or certificate of limited partnership.

13.11 JOINT AND SEVERAL LIABILITY. All parties signing this Sublease as Tenant shall be jointly and severally liable for all obligations of Tenant.

13.12 FORCE MAJEURE. If Landlord cannot perform any of its obligations due to events beyond Landlord's control, the time provided for performing such obligations shall be extended by a period of time equal to the duration of such events. Events beyond Landlord's control include, but are not limited to, acts of God, war, civil commotion, labor disputes, strikes, fire, flood or other casualty, shortages of labor or material, government regulation or restriction and weather conditions.

13.13 NO OPTION. The submission of this Sublease for examination does not constitute a reservation of or option to sublease the Premises and this Sublease becomes effective only upon execution and delivery thereof by Landlord and Tenant.

13.14 BROKERS. Landlord shall pay any commissions or fees that are payable to the broker specified in Section 1.11 ("Broker") with respect to this Sublease in accordance with the provisions of a separate commission contract. Landlord shall have no further or separate obligation for payment of commissions or fees to any other real estate broker,

finder or intermediary. Tenant represents that it has not had any dealings with any real estate broker, finder or intermediary with respect to this Lease, other than Broker. Subject to the foregoing, each party hereto shall indemnify and hold harmless the other party hereto from and against any and all losses, damages, liabilities, losses, costs and expenses (including, but not limited to, reasonable attorneys' fees and related costs) resulting from any claims that may be asserted against such other party by any real estate broker, finder or any intermediary arising from any acts of the indemnifying party in connection with this Lease.

13.15 HAZARDOUS SUBSTANCE CONDITIONS. If a Hazardous Substance Condition occurs, unless Tenant or its agents, employees, contractors or invitees are responsible therefor in accordance with Section 5.4, Landlord may at Landlord's option investigate and remediate such Hazardous Substance Condition, if required, as soon as reasonably possible at Landlord's expense.

| LANDLORD: | TENANT: |
| --- | --- |
| SORRENTO MONTANA, L.P.<br>a California Limited Partnership | Camino Neuro Care, Inc., A Delaware Corporation |
| By: CDS Property Services, Inc.<br>dba Sorrento Management Company,<br>A California Corporation | By:___________________________<br>Name:_________________________<br>Title:________________________<br>Date:_________________________ |
| By:___________________________<br>Name:_________________________<br>Title: Agent/Broker<br>Date:_________________________ | |

ADDITIONAL PROVISIONS
SUBLEASE RIDER

This Additional Provisions Rider ("Rider") is attached to and made a part of that certain industrial Real Estate Triple Net Sublease dated January 15, 1997, by and between Sorrento Montana, L.P., a California Limited Partnership, as Landlord and Camino NeuroCare Inc., a Delaware Corporation as Tenant, covering the Premises commonly known as 5955 Pacific Center Boulevard, Suites #709 through #713, San Diego, California 92121 (the "Sublease"). The terms used in this Rider shall have the same definitions as set forth in the Sublease and the other riders attached to and a part of the Sublease. The provisions of this Rider shall supersede any inconsistent or conflicting provisions of the Sublease, including the other riders attached to and a part of the Sublease.

1. Extension Options: Landlord hereby grants to Tenant an option ("Option") to extend the initial term of the Sublease for two (2) additional and consecutive periods, the first of which shall be eighteen (18) months, and the second of which shall be twenty-four (24) months commencing immediately upon the expiration of the initial term of the Sublease ("Extended Terms"), Tenant may exercise its Option to extend the term of the Sublease by given written notice of exercise to Landlord not more than one hundred eighty (180) days and not less than one hundred twenty (120) days prior to the expiration of the then term of the Sublease. Tenant shall not be entitled to exercise its Option to renew the Term of the Sublease pursuant hereto if: (a) Tenant is in default under the Sublease at the time of exercise of the Option; (b) Tenant is in default under the Sublease at the expiration of the Term hereof; or (c) Tenant has previously been in material default as defined in Section 10.2 of the Sublease on three (3) or more separate occasions during any twelve month period during the Sublease Term.

If Tenant elects to exercise its initial eighteen (18) month Option pursuant to the above provisions, and subsequent thereto, Tenant desires to elect to exercise its twenty-four (24) month Option, the procedure for electing its twenty-four (24) month Option shall be governed by the above procedures. In the event Tenant exercises its Option for one or both of the Extended Terms, the terms and conditions of the Sublease shall continue to govern during each extended term, with the exception that the Base Rent payable by Tenant during each Extended Term ("Option Rent") shall be equal to the Fair Market Rental Value of the Premises as of the commencement date of each Extended Term, but in no event shall the Option Rent be less than one hundred three percent (103%) of the Base Rent payable by Tenant for the month immediately preceding the commencement of such Extended Term. For the purpose of this paragraph, Fair Market Rental Value shall be the rental rate at which tenants lease comparable space within the Mira Mesa Distribution Center as of the commencement of the applicable Extension Term. All references in the Sublease to the "Term" shall include the initial term and one or both Extended Terms, as applicable. If Tenant fails to exercise its Option (whether voluntarily or because Tenant is in default as described above) with respect to the first Extended Term, Tenant shall not be entitled to exercise its Option with respect to the second Extended Term.

2. Improvements To The Premises: Tenant is subleasing the Premises from Landlord in an "as is" condition, with the following exceptions which shall be completed at Landlord's cost:

Suite #709 - Remove existing vinyl tile and carpeting; replace carpeting ("Building Standard" 20-ounce commercial grade glue down) and vinyl tile ("Building Standard" 12" by 12" Vinyl Composition Tile of 1/8" thickness); remove existing rest room walls and "cap off" existing plumbing fixtures; repaint interior walls; provide "Building Standard" window coverings for existing windows.

Suite #710 - Enclose and paint two existing fire wall penetrations; remove existing floor coverings and replace with "Building Standard" glue-down carpet and vinyl composition tile as hereinabove described; repaint interior walls; provide "Building Standard" window coverings for existing windows.

Suites #711 - #713 - Patch and repaint existing interior walls (or the square footage area equivalent thereof); provide and install "Building Standard" floor coverings throughout; provide "Building Standard" window coverings for existing windows.

All other costs associated with Tenant's desired improvements to the premises shall be at Tenant's expense, including but not limited to demolition of non-bearing interior walls and ceiling grid system installation of underground telephone conduit between the Premises and the existing building at 5955 Pacific Center Boulevard.

Except as specifically provided in this Additional Provisions Sublease Rider, all of the terms, conditions and definitions set forth in the Sublease shall remain unchanged and in full force and effect, In the event of any conflict between this Additional Provisions Sublease Rider and the Sublease, the terms of this Additional Provisions Sublease Rider shall prevail.

LANDLORD: TENANT:

SORRENTO MONTANA, L.P.
A California Limited Partnership

By: Sorrento Management Company,
A California Corporation

By:____________________________
Name:__________________________
Title:_________________________
Date:__________________________

CAMINO NEURO CARE, Inc.,
A Delaware Corporation

By:____________________________
Title:_________________________
Date:__________________________

# FIRST AMENDMENT TO SUBLEASE

THIS FIRST AMENDMENT TO SUBLEASE ("First Amendment") is made as of May 1, 1997 by and between SORRENTO MONTANA, L.P. a California Limited Partnership ("Landlord") and CAMINO NEUROCARE, INC., A Delaware Corporation ("Tenant"). with reference to the following facts and circumstances:

A. Landlord and Tenant previously entered into a Sublease dated January 15, 1997 ("Sublease") for approximately 1,728 square feet of premises commonly known as 5965 Pacific Center Boulevard, Suite #708, San Diego, California 92121 ("Premises").

B. Landlord and Tenant desire to modify, amend and supplement the Sublease as follows effective May 1, 1997:

1. Paragraph 1.4 ("PREMISES") is amended to add the approximately 1,728 square foot Suite #708 to the Premises subleased by Tenant from Landlord.

2. Paragraph 1.9.1 ("BASE RENT") is amended to increase the Base Rent payable by Tenant by One Thousand One Hundred Twenty Three and 20/100 Dollars ($1,123.20) per month, or a combined Base Rent of Six Thousand Four Hundred Fifty Three and 20/100 Dollars ($6,453.20) for Suites #708 through #713.

3. Paragraph 2 ("IMPROVEMENTS TO THE PREMISES") of the Additional Provisions Sublease Rider is hereby amended to provide that Tenant is subleasing Suite #708 in an "as is" condition. Notwithstanding the foregoing, Landlord shall provide Tenant with an allowance of Ten Thousand and No/100 Dollars ($10,000.00) to offset the cost of Tenant's desired improvements to the Premises.

4. Except as specifically provided in this First Amendment, all of the terms, conditions and definitions set forth in the Sublease shall remain unchanged and in full force and effect. In the event of any conflict between this First Amendment and the Sublease, the terms of this First Amendment shall prevail.

IN WITNESS WHEREOF, the parties hereto have executed this First Amendment To Sublease effective the day and year first written above.

| LANDLORD: | TENANT: |
|---|---|
| SORRENTO MONTANA, L.P.<br>A California Limited Partnership | CAMINO NEUROCARE, Inc.,<br>A Delaware Corporation |
| By: Sorrento Management Company,<br>A California Corporation | By:____________________________<br>Title:_________________________<br>Date:__________________________ |
| By:____________________________<br>Name:__________________________<br>Title:_________________________<br>Date:__________________________ | |

SECOND AMENDMENT TO SUBLEASE

THIS SECOND AMENDMENT TO SUBLEASE ("Second Amendment") is made as of May 1, 1998 by and between SORRENTO MONTANA, L.P., a California Limited Partnership ("Landlord") and CAMINO NEUROCARE, INC., A Delaware Corporation ("Tenant"), with reference to the following facts and circumstances:

A. Landlord and Tenant previously entered into a Sublease dated January 15, 1997 ("Sublease") for approximately 8,200 square feet of premises commonly known as 5966 Pacific Center Boulevard, Suite #709 through #713, San Diego, California 92121 ("Premises").

B. Landlord and Tenant subsequently modified amended and supplemented the Sublease through First Amendment To Sublease dated May 1, 1997 adding the approximately 1,728 square foot Suite #708 to the Premises.

C. Landlord and Tenant desire to modify, amend and supplement the Sublease as follows effective May 1, 1998:

1. Paragraph 1.4 ("PREMISES") is amended to (a) add the approximately 1,728 square foot Suite #706 to the Premises subleased by Tenant from Landlord effective May 1. 1998, and (b) add the approximately 1,728 square foot Suite #707 effective August 1, 1998.

2. Paragraph 1.9.1 ("BASE RENT") is amended to (a) increase the Base Rent payable by Tenant by One Thousand One Hundred Fifty Seven and 76/100 Dollars ($1,157.76) per month for Suite #706 effective May 1, 1998, and (b) increase the Base Rent payable by Tenant by an additional One Thousand One Hundred Fifty Seven and 76/100 Dollars ($1,157.76) per month for Suite #707 effective August 1, 1998. Base Rent for all Premises included under the January 15, 1997 Sublease as subsequently amended By First Amendment dated May 1, 1997 and Second Amendment dated May 1, 1998 shall be increased three percent (3%) each January 1 throughout the remainder of the Sublease term.

3. Paragraph 2 ("IMPROVEMENTS TO THE PREMISES") of the Additional Provisions Sublease Rider Is hereby amended to provide that Tenant is subleasing Suite #707 in an "as is" condition. Landlord shall provide Tenant with an allowance of Three Thousand Five Hundred and No/100 Dollars ($3,500.00) to offset the cost of Tenant's desired improvements to Suite #706.

4. Paragraph 14.0 ("RIGHT OF FIRST REFUSAL") is hereby added to provide Tenant with a one-time Right Of First Refusal to sublease the approximately 4,956 square foot Suites #702 through #705, which are expected to be vacated by the present occupant on or about June 15, 1998. Tenant shall have three days from notification by Landlord of receipt of an acceptable offer from an outside third party to sublease Suites #702 through #705 within which to commit in writing to subleasing the space upon the same terms and conditions as offered by the outside third party. Tenant's failure to respond in writing to Landlord's notification shall be deemed a waiver of the on-time Right.

5. Except as specifically provided in this Second Amendment, all of the terms, conditions and definitions set forth in the Sublease shall remain unchanged and in full force and effect. In the event of any conflict between this First Amendment and the Sublease, the terms of this Second Amendment shall prevail.

IN WITNESS WHEREOF, the Parties hereto have executed this First Amendment To Sublease effective the day and year first written above.

| LANDLORD: | TENANT: |
|---|---|
| SORRENTO MONTANA, L.P.<br>A California Limited Partnership | CAMINO NEUROCARE, Inc.,<br>A Delaware Corporation |
| By: Sorrento Management Company,<br>A California Corporation | By:____________________________<br>Title:_________________________<br>Date:__________________________ |
| By:____________________________<br>Name:__________________________<br>Title:_________________________<br>Date:__________________________ | |

THIRD AMENDMENT TO SUBLEASE

THIS THIRD AMENDMENT TO SUBLEASE ("Third Amendment") is made as of February 1, 1999 by and between SORRENTO MONTANA, L.P., a California Limited Partnership ("Landlord") and CAMINO NEUROCARE, INC., a Delaware Corporation ("Tenant") with reference to the following facts and circumstances:

A. Landlord and Tenant previously entered into a Sublease dated January 15, 997 ("Sublease") for approximately 8,200 square feet of premises commonly known as 5965 Pacific Center Boulevard, Suite #709 through #713, San Diego, California 92121 ("Premises").

B. Landlord and Tenant subsequently modified, amended and supplemented the Sublease through First Amendment To Sublease dated May 1, 1997 adding the approximately 1,728 square foot Suite #708 to the Premises.

C. Landlord and Tenant further modified, amended and supplemented the Sublease through Second Amendment To Sublease dated May 1, 1998, adding the approximately 1,728 square foot Suite #706 effective May 1, 1998, and the approximately 1,728 square foot Suite #707 effective August 1, 1998.

D. Landlord and Tenant desire to further modify, amend and supplement the Sublease as follows effective February 1, 1999:

1. Paragraph 1.4 ("PREMISES") is amended to add the approximately 1,618 square foot Suite #714 to the Premises subleased by Tenant from Landlord effective February 1, 1999.

2. Paragraph 1.9.1 ("BASE RENT") is amended to increase the Base Rent payable by Tenant by One Thousand One Hundred Sixteen and 47/100 Dollars ($1,116.47) per month for Suite #714 effective February 1, 1999. Effective January 1, 2000, Base Rent for all Premises included under the January 15, 1997 Sublease as subsequently amended By First Amendment dated May 1, 1997, Second Amendment dated May 1, 1998 and this Third Amendment dated February 1, 1999, shall be increased to $0.725 NNN per square foot of Premise's per month, plus three percent (3%) increases each January 1 thereafter throughout the term of the Sublease and any extensions thereof.

3. Paragraph 1.5 ("SUBLEASE TERM") is amended to extend the term of the Sublease an additional eighteen months through June 30, 2001. This extension of the Sublease Term shall be considered the exercise of the first of Tenant's of two extension options contained in the Additional Provisions Sublease Rider to Tenant's Sublease dated January 15, 1997.

4. Paragraph 2 ("IMPROVEMENTS TO THE PREMISES") of the Additional Provisions Sublease Rider is hereby amended to provide that Tenant is subleasing Suite #707 in an "as is" condition. Notwithstanding the foregoing, Landlord shall provide Tenant with an allowance of Four Thousand and No/100 Dollars ($4,000.00) to offset the cost of Tenant's desired modifications to Suite #714.

5. Except as specifically provided in this Third Amendment, all of the terms, conditions and definitions set forth in the Sublease shall remain unchanged and in full force and effect. In the event of any conflict between this Third Amendment and the Sublease, the terms of this Third Amendment shall prevail.

IN WITNESS WHEREOF, the Parties hereto have executed this First Amendment To Sublease effective the day and year first written above.

LANDLORD:

SORRENTO MONTANA, L.P.
A California Limited Partnership

By: Sorrento Management Company,
A California Corporation

By:____________________________
Name:__________________________
Title:_________________________
Date:__________________________

TENANT:

CAMINO NEUROCARE, Inc.,
A Delaware Corporation

By:____________________________
Title:_________________________
Date:__________________________

[Floorplan of Building 7]

EXHIBIT "A"

[Floorplan of Building 7 including description and map]

EXHIBIT "B"

[Original Concept Design]

EXHIBIT "C"

Exhibit 21

Subsidiaries of Integra LifeSciences Holdings Corporation

| Name of Subsidiary | State of Incorporation or Organization |
| --- | --- |
| 1. Camino NeuroCare, Inc | Delaware |
| 2. Heyer-Schulte NeuroCare, Inc. | Delaware |
| 3. Integra LifeSciences Corporation | Delaware |
| 4. Integra NeuroCare LLC | Delaware |
| 5. LifeSciences Services Corporation | Delaware |
| 6. NeuroCare Holding Corporation | Delaware |
| 7. Redmond NeuroCare LLC | Delaware |
| 8. Rystan Company, Inc. | New Jersey |
| 9. Telios Pharmaceuticals, Inc. | Delaware |

Exhibit 23

# CONSENT OF INDEPENDENT ACCOUNTANTS

We consent to the incorporation by reference in the registration statements of Integra LifeSciences Holdings Corporation and Subsidiaries on Form S-8 (File Nos. 333-82233, 333-58235 and 333-06577) of our reports dated March 1, 2000 (except for Note 20, as to which the date is March 29, 2000), on our audits of the consolidated financial statements and financial statement schedules of Integra LifeSciences Holdings Corporation, as of December 31, 1999 and 1998, and for each of the three years in the period ended December 31, 1999, which reports are included in this Annual Report on Form 10-K.

PricewaterhouseCoopers LLP
Florham Park, New Jersey
March 30, 2000

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YEAR
DEC-31-1999
JAN-01-1999
DEC-31-1999
19,301
4,311
9,309
944
10,111
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(8,018)
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