

Alphatec Holdings, Inc.  
Form 10-K  
March 20, 2014

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

Form 10-K

(Mark One)

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

For the fiscal year ended December 31, 2013

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number: 000-52024

ALPHATEC HOLDINGS, INC.  
(Exact Name of Registrant as Specified in its Charter)

Delaware  
(State or Other Jurisdiction of  
Incorporation or Organization)  
5818 El Camino Real, Carlsbad,  
California  
(Address of Principal Executive Offices)  
(760) 431-9286  
(Registrant's Telephone Number, Including Area Code)

20-2463898  
(I.R.S. Employer  
Identification No.)  
92008  
(Zip Code)

Securities registered pursuant to Section 12(b) of the Exchange Act:

Title of Each Class  
Common Stock, par value \$0.0001 per share  
Securities registered pursuant to Section 12(g) of the Exchange Act: None

Name of Each Exchange on Which Registered  
The NASDAQ Global Select Market

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes  No

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  No

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

Indicate by check mark 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 the registrant's knowledge, in definitive proxy or information

Edgar Filing: Alphatec Holdings, Inc. - Form 10-K

statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. "

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

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

The aggregate market value of the registrant's common stock held by non-affiliates of the registrant (without admitting that any person whose shares are not included in such calculation is an affiliate) based on the last reported sale price of the common stock on June 28, 2013 was approximately \$126.5 million.

The number of outstanding shares of the registrant's common stock, par value \$0.0001 per share, as of March 19, 2014 was 97,600,388.

**DOCUMENTS INCORPORATED BY REFERENCE**

The following documents (or parts thereof) are incorporated by reference into the following parts of this Form 10-K: Certain information required in Part III of this Annual Report on Form 10-K is incorporated from the Registrant's Proxy Statement for the 2014 Annual Meeting of Stockholders.

---

ALPHATEC HOLDINGS, INC.  
 FORM 10-K—ANNUAL REPORT  
 For the Fiscal Year Ended December 31, 2013  
 Table of Contents

	Page
<b><u>PART I</u></b>	
<b><u>Item 1.</u></b> Business	<u>1</u>
<b><u>Item 1A.</u></b> Risk Factors	<u>17</u>
<b><u>Item 1B.</u></b> Unresolved Staff Comments	<u>36</u>
<b><u>Item 2.</u></b> Properties	<u>37</u>
<b><u>Item 3.</u></b> Legal Proceedings	<u>37</u>
<b><u>Item 4.</u></b> Mine Safety Disclosures	<u>38</u>
<b><u>PART II</u></b>	
<b><u>Item 5.</u></b> Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	<u>39</u>
<b><u>Item 6.</u></b> Selected Financial Data	<u>41</u>
<b><u>Item 7.</u></b> Management’s Discussion and Analysis of Financial Condition and Results of Operations	<u>42</u>
<b><u>Item 7A.</u></b> Quantitative and Qualitative Disclosures About Market Risk	<u>55</u>
<b><u>Item 8.</u></b> Financial Statements and Supplementary Data	<u>55</u>
<b><u>Item 9.</u></b> Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	<u>55</u>
<b><u>Item 9A.</u></b> Controls and Procedures	<u>56</u>
<b><u>Item 9B.</u></b> Other Information	<u>58</u>
<b><u>PART III</u></b>	
<b><u>Item 10.</u></b> Directors, Executive Officers and Corporate Governance	<u>59</u>
<b><u>Item 11.</u></b> Executive Compensation	<u>59</u>
<b><u>Item 12.</u></b> Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	<u>59</u>
<b><u>Item 13.</u></b> Certain Relationships and Related Transactions, and Director Independence	<u>59</u>
<b><u>Item 14.</u></b> Principal Accounting Fees and Services	<u>59</u>
<b><u>PART IV</u></b>	
<b><u>Item 15.</u></b> Exhibits, Financial Statement Schedules	<u>60</u>

In this Annual Report on Form 10-K, the terms “we,” “us,” “our,” “Alphatec Holdings” and “Alphatec” mean Alphatec Holdings, Inc. and our subsidiaries and affiliates. “Alphatec Spine” refers to our wholly-owned operating subsidiary Alphatec Spine, Inc. “Scient’x” refers to our operating affiliate, Scient’x S.A.S., which is wholly-owned by several of our subsidiaries, and Scient’x S.A.S.’s subsidiaries.

## PART I

### Item 1. Business

#### Overview

We are a medical technology company focused on the design, development, manufacturing and marketing of products for the surgical treatment of spine disorders. We have a comprehensive product portfolio and pipeline that addresses the cervical, thoracolumbar and intervertebral regions of the spine and covers a variety of major spinal disorders and surgical procedures. Our principal product offerings are focused on the global market for orthopedic spinal disorder solutions. Our “physician-inspired culture” enables us to respond to changing surgeon needs through collaboration with spinal surgeons to conceptualize, design and co-develop a broad range of products. We have a state-of-the-art, in-house manufacturing facility that provides us with a unique competitive advantage, and enables us to rapidly deliver solutions to meet surgeons’ and patients’ critical needs. We believe that our products and systems have enhanced features and benefits that make them attractive to surgeons and that our broad portfolio of products and systems provide a comprehensive solution for the safe and successful surgical treatment of spinal disorders.

#### Strategy

Our strategy is to be a leading global independent full-line spine company by providing products for the surgical treatment of spinal disorders. Spinal disorders arise from degenerative conditions, deformities, trauma-based disorders and tumors such as poor bone density, vertebral compression fractures, adult deformity or scoliosis, degenerative disc disease, and spinal stenosis. Our broad line of spinal products is used to treat many of these conditions and facilitate the spinal procedures necessary to correct them. Most of our products are designed to promote spinal fusion. Spinal fusion surgery is designed to stabilize the spine after the defect has been corrected until natural bone healing or fusion, occurs. We sell implant products that interlock the segments of the spine until natural spinal fusion takes place. Additionally, we offer a broad line of biologic products that help promote or accelerate spinal fusion. To further differentiate our solutions, we have incorporated minimally invasive surgical, or MIS, devices and techniques and biologics-based solutions into our portfolio to improve patient outcomes. We achieve this through internal product development, technology acquisition, product licensing and by responding to surgeon feedback and input. We believe that we have developed a strong product platform for consistent and measured growth and intend to leverage this platform by, among other things, providing unmatched service to, and taking scientific direction from, surgeons. In addition to bringing innovative products to market, we understand that surgeons are a critical component of the product development process. Accordingly, we view our relationship with the surgeon community as an integral component of our strategy.

The key elements of our strategy are:

**Develop Physician-Inspired Innovative Products and Solutions.** One of our core competencies is our ability to develop and commercialize creative spinal implants and instruments that incorporate the knowledge, insights and experience of practicing surgeons. We believe that through these collaborations we can significantly advance our product portfolio and product lifecycle plans by developing innovative products and technologies. We believe that our short-term and long-term product pipeline will offer us increased revenue opportunities by addressing a wider range of spine disorders and improving patient outcomes.

**Focus on Rapidly Growing Segments of the Market: MIS and Biologics.** We plan to expand our MIS implant offerings and techniques, which are designed to result in quicker recovery, decreased operative blood loss and decreased hospitalization time for the patient. Additionally, we plan to grow our biologics portfolio with products that aid in bone healing and fusion for a wide variety of spinal surgeries. We believe that our strategic focus on the rapidly growing MIS and biologics market should increase our revenue and market penetration globally.

**Continually Enhance our Product Portfolio through Focused Innovation.** We offer a full range of spinal devices and surgical instruments used to treat spine disorders across the world. We believe that this comprehensive approach enables us to maximize our revenue for each procedure by fulfilling a greater portion of a surgeon’s spine product needs. We intend to continue to enhance our product offerings by developing, licensing and acquiring technologies that we can market broadly through our global sales organization to our established surgeon base and surgeons not yet using our products.

Grow our U.S. Business. Our products are sold in the U.S. through a network of independent distributors and direct sales representatives. We continually seek ways to increase the size and quality of this sales and distribution network to reach a broader base of surgeons, hospitals, and national accounts across the U.S. as well as deepen penetration in existing accounts and territories.

1

---

Expand our International Business. We believe our well-established global platform provides a strong foundation for us to continue to grow our business internationally. Today we have existing subsidiaries and/or affiliates in Japan, Germany, Brazil, Hong Kong, Italy and the U.K. through which we sell our products and independent distributors in over 50 countries throughout the world. We plan to continue to grow our international presence by expanding our distribution network and through the registration and commercialization of additional product offerings throughout the world.

Grow Market Share through Accretive Acquisitions and Collaborations. In addition to growing our company through internal research and product development efforts, we plan on selectively licensing or acquiring complementary products, technologies, or companies that support our mission of providing physician-inspired solutions to patients with spinal disorders. We believe that supplementing our organic growth with accretive deal structures will help accelerate our growth.

Continuously Drive our Manufacturing and Supply Chain Efficiencies and Fiscal Discipline. We are a vertically integrated company with a major global manufacturing facility in our Carlsbad, California headquarters. We continue to employ lean excellence manufacturing and Six Sigma concepts to streamline our operations to drive efficiencies and lower costs. We believe that these lean principles and continuous improvement efforts will enhance our operating efficiencies and improve our ability to compete in an increasingly price-sensitive healthcare industry.

#### Scient'x Restructuring

On September 16, 2013, we announced that Scient'x has begun a process to significantly restructure its business operations in France in an effort to improve operating efficiencies and rationalize its cost structure. The restructuring includes a reduction in Scient'x's workforce and closing of the manufacturing facilities in France. We estimate that we will record total costs, including employee severance, social plan benefits and related taxes, facility closing costs, manufacturing transfer costs, and contract termination costs of approximately \$12 million associated with this restructuring. We recorded a restructuring charge accrual in accrued expenses of \$9.2 million within the consolidated balance sheets as of December 31, 2013 and restructuring expenses within the consolidated statements of operations for the year ending December 31, 2013. We estimate that we will record severance and benefits of approximately \$9.7 million and facility closing and other restructuring costs of approximately \$2.2 million. We expect to complete all the activities associated with the restructuring activities by the end of the second quarter of 2014, a substantial portion of which will be paid by then. We anticipate that the restructuring of Scient'x will reduce our operating expenditures by between \$2 to \$6 million on an annualized basis. The restructuring is part of our strategy of streamlining our organization and lowering cost structures, which we expect will improve our financial condition in 2014 and beyond.

#### Spine Anatomy

The human spine is the core of the human skeleton and provides important structural support while remaining flexible to allow movement. The human spine is a column of 33 bones that protects the spinal cord and enables people to stand upright. Each bony segment of the spine is referred to as a vertebra (two or more are called vertebrae). The spine has five regions containing groups of similar bones, listed from top to bottom: seven cervical vertebrae in the neck, 12 thoracic vertebrae in the mid-back (each attached to a rib), five lumbar vertebrae in the lower back, five sacral vertebrae fused together to form one bone in the hip region, and four coccygeal bones fused together that form the tailbone. At the front of each vertebra is a block of bone called the vertebral body. The vertebral body consists of an inner core of soft cancellous bone, surrounded by a thin outer layer of hard cortical bone. Vertebrae are stacked on top of each other and enable people to sit and stand upright. Vertebrae in the cervical, thoracic and lumbar regions are separated from each other and cushioned by a rubbery soft tissue called the intervertebral disc. Segments of bone that extend outward at the back of each cervical, thoracic and lumbar vertebral body surround and protect the spinal cord and its nerve roots. These bones, known as the posterior spinous processes, can be felt along the middle of a person's back.

#### Disorders Affecting the Spine

There are four major categories of spine disorders: degenerative conditions, deformities, trauma-based disorders and tumors. While our product offering addresses all four categories, the majority of our business is concentrated on products used in the treatment of degenerative and deformity conditions. These conditions can result in instability and pressure on the nerve roots as they exit the spinal column, causing back pain and potentially pain in the arms or legs.

Some of the most common degenerative conditions and deformities affecting the spine are as follows:

Degenerative disc disease is a common medical condition affecting the cervical, thoracic and lumbar regions of the spine and refers to the degeneration of the disc from aging and repetitive stresses, resulting in a loss of flexibility, elasticity and shock-absorbing properties. As degenerative disc disease progresses, the space between the vertebrae narrows, or the disc

can bulge or rupture, which can pinch the nerves exiting the spine and result in back pain, leg pain, numbness and loss of motor function. This back pain can be overwhelming for patients as the resulting pain can have significant physical, psychological and financial implications.

Spinal stenosis is a narrowing of the spinal canal, which places pressure on the spinal cord. If the stenosis is located on the lower part of the spinal cord, it is called lumbar spinal stenosis. Stenosis in the upper part of the spinal cord is called cervical spinal stenosis. While spinal stenosis can be found in any part of the spine, the lumbar and cervical areas are the most commonly affected. Some patients are born with this narrowing, but most often spinal stenosis is seen in patients over the age of 50. In these patients, stenosis is the gradual result of aging and wear and tear on the spine during everyday activities.

Spondylolisthesis occurs when one vertebra slips forward in relation to an adjacent vertebra, usually in the lumbar spine. The symptoms that accompany spondylolisthesis include pain in the lower back and legs, and muscle spasms and weakness. Spondylolisthesis can be congenital or develop later in life. The disorder may result from physical stresses to the spine, intense physical activity, and general wear and tear.

A Vertebral compression fracture, or VCF, occurs when a vertebra in the spinal column fractures or collapses. Vertebral compression fractures have multiple acute and chronic consequences, including back pain, loss of back function and diminished quality of life. Chronic consequences of a VCF can also result in pulmonary and gastric dysfunction, as well as depression. Deformity resulting from a VCF worsens these problems and can increase the risk of another fracture, which can further exacerbate complications from the initial VCF, including an increase in the loss of mobility and ultimately increased mortality.

#### The Alphatec Solution

Our principal product offering includes a wide variety of spinal implant products and systems comprised of components such as spine screws and rods, spinal spacers, plates, and various biologics offerings. In addition, outside of the U.S. we sell solutions for treating vertebral compression fractures, or VCFs and spinal stenosis. Certain of our biologics offerings are used as an alternative to synthetic products while others complement our synthetic products by promoting fusion.



The chart below illustrates the principal products in our broad portfolio of spine systems currently available for sale by market segment. Certain systems and products are described in greater detail below the chart. \* Items marked with an asterisk are not available for sale in the U.S.

Current Products:

Market Segment	Principal Products
Cervical and Cervico-thoracic	Trestle Anterior Cervical Plate Trestle Luxe Anterior Cervical Plate Solanas Posterior Cervico/Thoracic Fixation System Avalon Occipital Plate DiscoCerv Artificial Disc* PCB Evolution* Zodiac Degenerative Fixation System Zodiac Deformity Fixation System with Smart Set ILLICO FS Fixation System TTL IN Fixation System* Xenon Fixation System BridgePoint Spinous Process Fixation System Isobar Evolution Dynamic Rod*
Thoracolumbar	Aspida Anterior Lumbar Interbody Plate System TTL-D Fixation System* Hemi Fixation System OsseoFix Spinal Fracture Reduction System* OsseoFix+ Vertebroplasty System OsseoScrew Spinal Fixation System* Novel Spinal Spacers Alphatec Solus Locking ALIF Spacer Samarys*/Samarys RF*
Spinal Spacers	Pegasus Anchored Cervical Interbody HeliFix Interspinous Spacer System* TeCorp* Illico MIS System OsseoScrew MIS System* Epicage TLIF System*
Minimally Invasive Surgery (MIS)	BridgePoint Spinous Process Fixation System AlphaGraft Structural Allograft Spacers AlphaGraft Demineralized Bone Matrix AlphaGraft ProFuse Demineralized Bone Scaffolds AmnioShield Amniotic Membrane NEXoss Synthetic Bone Graft
Biologics	

Cervical and Cervico-Thoracic Products

Trestle Luxe Anterior Cervical Plate System

Our Trestle Luxe Anterior Cervical Plate System has a large window that enables the surgeon to have improved graft site and end plate visualization; which is designed to allow for better placement of the plate. The Trestle Luxe Anterior Cervical Plate System also has a low-profile design, which we believe is among the lowest in the spine market. Low-profile cervical plates are intended to reduce the irritation of the tissue adjacent to the plate following surgery. Other key features of the Trestle Luxe Anterior Cervical Plate system include a self-retaining screw-locking

mechanism that is designed to ensure quick and easy locking of the plate and a flush profile after the screws are inserted.

Solanas Posterior Cervico/Thoracic Fixation System and Avalon Occipital Plate

Our Solanas Posterior Cervico/Thoracic Fixation System consists of rods, polyaxial screws, hooks, and connectors that provide a solution for posterior cervico/thoracic fusion procedures. We also designed the Solanas Posterior Cervico/Thoracic System to be used in combination with our existing Zodiac Degenerative Spinal Fixation System and our Avalon Occipital Plate, thereby providing surgeons with a solution for occipito-cervico-thoracic fixation. The Avalon Occipital Plate has a

unique buttress design for optimal bone graft placement and superior fusion, including three points of plate rotation and translation, which is designed to ease the placement of the plate.

#### DiscoCerv Artificial Disc

Our DiscoCerv product is a cervical disc prosthesis. The design consists of convex upper and lower plates that are designed to fit into the anatomical curvature of the disc space. The disc provides angulations of nine degrees in the sagittal and coronal planes to preserve the physiological amplitude of a normal disc. The DiscoCerv Artificial Disc is not available for sale in the U.S.

#### Thoracolumbar Fixation Products

##### Zodiac Degenerative Spinal Fixation System

Our Zodiac Degenerative Spinal Fixation System is a comprehensive spinal system that offers a wide variety of polyaxial pedicle screws, connectors and advanced instruments for the stabilization of the thoracolumbar spine. The Zodiac Degenerative Spinal Fixation System offers surgeons a low-profile, friction-fit polyaxial screw with up to 76 degrees of variability and a secure buttress thread closure mechanism that eases final construct assembly. Our Zodiac Degenerative Spinal Fixation System offers pre-cut and pre-contoured rods, which allow surgeons to customize each construct depending on the patient's needs. The Zodiac Degenerative Spinal Fixation System is designed to be used in combination with Novel Spinal Spacers and AlphaGraft Structural Allograft Spacers.

##### Zodiac Deformity Spinal Fixation System

Our Zodiac Deformity Spinal Fixation System is a comprehensive system of instrumentation and implants designed to enable the surgeon to address patient-specific spinal deformity correction procedures. The Zodiac Deformity Spinal Fixation System contains polyaxial screws that are similar in design to those in the Zodiac Degenerative Spinal Fixation System. The Zodiac Deformity Spinal Fixation System offers components that are frequently used in deformity correction procedures, such as fixed and uniplanar screws, high-strength deformity rods, including cobalt chromium, hooks, rod connectors, pelvic-fixation implants and deformity specific instrumentation. The Zodiac Degenerative Fixation System is designed to be used in combination with Novel Spinal Spacers and AlphaGraft Structural Allograft Spacers.

##### Aspida Anterior Lumbar Interbody Fusion, or ALIF, Plate System

Our Aspida ALIF Plate System is designed to be used in conjunction with a spacer, and is intended to offer comparable stabilization to pedicle screw and rod systems. Our Aspida ALIF Plate System is designed to provide surgeons with the option of performing a single anterior procedure without having the need for a complementary posterior procedure. The Aspida ALIF Plate System is designed to be anatomically shaped and have a low profile, which is intended to minimize the risk of irritation or damage to the adjacent tissue.

##### OsseoFix Spinal Fracture Reduction System

Our OsseoFix Spinal Fracture Reduction System provides a solution for VCF indications. The OsseoFix implant is an expandable titanium cage that is designed to be implanted in a minimally invasive manner into a vertebral body to treat a VCF. The OsseoFix system is designed to provide the surgeon with control over the placement and expansion of the device as the fracture is treated. In addition, the OsseoFix System is designed to use less polymethyl methacrylate, or PMMA, bone cement than current standards of care and may overcome one of the primary complications of kyphoplasty and vertebroplasty, which is the potential risk of extravasation of bone cement into the spinal canal or venous system. The OsseoFix System is not available for sale in the U.S.

##### OsseoScrew Spinal Fixation System

The OsseoScrew Spinal Fixation System is an innovative pedicle screw system that is designed to provide a solution for patients who have poor bone density. The OsseoScrew System is designed to be implanted into the pedicle and then expanded after implementation to achieve increased screw fixation in bone with poor density. The OsseoScrew Spinal Fixation System is not available for sale in the U.S.

## Spinal Spacers

### Novel PEEK and Titanium Spinal Spacers

Our family of Novel spinal spacers addresses the surgical need to accommodate varying patient anatomies, surgical approaches and composite material options. We offer multiple unique implant designs, each of which is available in numerous shapes and heights. Certain of our Novel spinal spacers are made of titanium and others are made of a strong, heat resistant, radiolucent, biocompatible plastic called polyetheretherketone, or PEEK. Our Novel PEEK spinal spacers have been approved for use in both the lumbar and cervical regions of the spine. A Novel PEEK spinal spacer is not visible during a magnetic resonance imaging, which allows the surgeon to better assess the progress of the healing process following surgery. Novel spacers and their accompanying instrumentation are designed to be inserted from several planes of the body to accommodate surgeons' needs. Novel spinal spacers feature sizable central openings that help accommodate the placement of bone grafting material inside and around the spacer, which we believe promotes fusion. A ridge pattern on the top and bottom of our Novel spacers helps prevent movement after placement and enhances the stability of the overall construct.

### Alphatec Solus Locking ALIF Spinal Spacer

Our Alphatec Solus locking ALIF spinal spacer, or Alphatec Solus, is a zero-profile PEEK and titanium device offering four points of fixation for improved stability. Alphatec Solus features a one-step insertion and deployment feature and is used in ALIF procedures. We believe that Alphatec Solus' locking mechanism is a substantial improvement over similar products currently on the market.

### Samarys/Samarys RF

Our Samarys PEEK cervical cage restores disc height as well as cervical lordosis. The cage is anatomically designed for immediate stability and optimum fusion with a large graft window. Neither Samarys nor Samarys/RF is approved for sale in the U.S.

### Pegasus Anchored Cervical Interbody

The Pegasus Anchored Cervical Interbody, or ACI, System provides surgeons a simplified approach to traditional anterior cervical disectomy and fusion, or ACDF. It features a single step delivery of a spacer with an integrated anchoring mechanism. The single-step, non-impaction and locking mechanism reduces operative time and simplifies a standard technique. Simple intra-operative and post-operative removal provides flexibility to the surgeon.

## MIS Products

### Illico Minimally Invasive Surgery System

The Illico Minimally Invasive Surgery System is a cannulated pedicle screw and rod system that is designed to be inserted via a minimally invasive surgical procedure. Access to the spine is gained through a small incision. The surgeon is then able to see the surgical site by using a small canal through which implants are inserted into the patient with a minimum amount of disruption to the surrounding tissue. We believe that the Illico Minimally Invasive System limits trauma to the tissue surrounding the location of the surgery, which is designed to enable patients to recover faster.

### Epicage TLIF System

The Epicage TLIF system addresses the disadvantages of traditional lumbar interbody fusion techniques. The system incorporates the ease of delivering a bullet-shaped cage and the biomechanically ideal shape of a crescent-shaped cage in a single implant. Using a unique set of delivery instruments, it accurately establishes the implant's trajectory to consistently deliver the cage.

### BridgePoint Spinous Process Fixation System

The BridgePoint system is a spinous process fixation system that was developed to address the disadvantages of traditional stabilization devices. The system allows surgeons to fixate the spine using a less invasive approach by attaching a plate to the spinous process of the vertebral body during spinal fusion surgery. The BridgePoint device is used as an adjunct to interbody fusion or posterior fusion with decompression treatment.

## Biologics

### AlphaGraft Structural Allograft Spacers

We offer a broad portfolio of allograft spacers available in a wide range of shapes and sizes, each with corresponding instrumentation, which are intended for use in the cervical, thoracic, and lumbar regions of the spine. In addition, many of our allograft spacers are packaged in our VIP packaging system, or VIP System. The VIP System is a packaging and fluid delivery system that allows for fast and efficient infusion of the surgeon's choice of hydration fluid. The VIP System provides rapid and uniform hydration, which may reduce the brittleness of the graft and shorten the length of the surgical procedure.

### AlphaGraft ProFuse Demineralized Bone Scaffold

Our AlphaGraft ProFuse Demineralized Bone Scaffold consists of a sponge-like demineralized bone matrix that has been pre-cut into sizes to fit within a spinal spacer. The AlphaGraft ProFuse Demineralized Bone Scaffold provides a natural scaffold derived entirely of bone that can be placed into a void within a spinal spacer or on top of a spinal spacer. The sponge-like qualities of the scaffold allow a surgeon to compress the scaffold and place it into a small space. Following placement, the scaffold expands for maximum contact between the spinal spacer and the endplate of the vertebral body and is designed to promote fusion. The AlphaGraft ProFuse Demineralized Bone Scaffold is pre-packaged in our proprietary VIP vacuum infusion packaging system.

### Amnioshield Amniotic Tissue Barrier

Our Amnioshield Amniotic Tissue Barrier is an allograft for spinal surgical barrier applications. The composite amniotic membrane reduces inflammation and enhances healing at the surgical site, reduces scar tissue formation and provides an excellent dissection plane.

### Alphagraft Demineralized Bone Matrix

Our Alphagraft Demineralized Bone Matrix consists of demineralized human tissue that is mixed with a bioabsorbable carrier and intended for use in surgery for bone grafting.

### NEXoss Synthetic Bone Graft

Our NEXoss nanostructure bioactive matrix is the next-generation synthetic that is an innovative bioactive scaffold for bone grafting. The Alphatec NEXoss biomimetic nanostructured hydroxyapatite crystals is designed to mimic bone composition, structure and size to resorb similar to naturally occurring hydroxyapatite.

## Sales and Marketing

In the U.S., we sell our products through a sales force consisting of independent distributors and direct sales representatives. Although surgeons in the U.S. typically make the ultimate decision to use our products, we bill hospitals for the products that are used and pay commissions to our independent distributors and direct sales agents based on payments received from hospitals. We compensate our sales employees through salaries and incentive bonuses based on performance measures. We select our distributors and sales force based on their expertise in selling spinal devices, reputation within the surgeon community, geographical coverage and established sales network. Increasingly, we contractually require our distributors to sell our products exclusively both within and outside of their allocated sales territory. We offer sales and product training to each of our independent distributors and direct sales representatives. We market our products at various industry conferences, organized surgical training courses, and in industry trade journals and periodicals. We plan on expanding our U.S. sales coverage through the use of additional distributors and direct sales representatives in order to support continued adoption of our products by new surgeons and increased use of our products by surgeons who currently use our products.

In general, outside of the U.S. we sell products directly to distributors, and our distributors resell our products to hospitals. In the markets in which we have a direct sales force, we bill the hospitals for the products that are used. In markets that use independent distributors, we sell our products to the distributor, and the distributor resells the products to the hospital. We plan to continue expanding our direct sales and distribution network and product offerings throughout the world. Similar to our sales and marketing activities in the U.S., outside of the U.S. we market our products at various international industry conferences, organized surgical training courses, and in industry trade journals and periodicals. In addition, we host several international educational conferences in Europe, Asia and Latin America and South America, including the International Spine Research and Innovation and Argos and Sisyphean Spinal Society meetings.



#### Surgeon Training and Education

We devote significant resources to train and educate surgeons in the proper use of our implants, instrumentation, and surgical access technologies. We believe that one of the most effective ways to introduce and build market demand for our products is by training and educating spine surgeons, independent distributors, and direct sales representatives in the benefits and use of our products. We believe that surgeons, independent distributors, and direct sales representatives will become exposed to the merits and distinguishing features of our products through our training and education programs, and in doing so, will increase the use and promotion of our products.

#### Research and Development

Our research and development department is continually upgrading the core product portfolio to increase our penetration of the sizable global spine market. We are also expanding the portfolio with innovative products in order to reach the few remaining large segments of the market in which we do not currently participate. Our goal is to become the market leader in providing physician-inspired solutions for patients with spinal disorders, by developing products with superior instrumentation which provide the best possible treatment. Pursuant to this goal, we collaborate with our surgeon partners to design products to enhance the surgeon experience, simplify surgical techniques, and reduce overall costs, while improving patient outcomes. In implementing this strategy, we are concentrating on converting our research and development programs into products that incorporate minimally invasive techniques and biologics solutions across all of our product lines.

#### Manufacture and Supply

We conduct a substantial portion of our manufacturing operations at our facilities in Carlsbad, California. We manufacture a significant amount of our non-biologic implants in-house. Certain of our implants and a significant amount of our instrumentation are purchased from third parties. We believe that the in-house production of our implants maximizes efficiency, reduces product development time, simplifies production scheduling, reduces inventory backlogs and is more responsive to the changing needs of surgeons. Our facilities include separate areas dedicated to the machining, tooling, quality control, cleaning and labeling of our products. Additionally, we have an advanced manufacturing group that includes design engineering and manufacturing personnel. The advanced manufacturing group is dedicated to providing rapid prototyping and innovative custom instrumentation for our research and development programs and our surgeon customers.

We devote significant time and attention to ensure that all of our products are safe, effective, adhere to all applicable regulations and are of the highest quality. An established and comprehensive quality system drives our focus from the initial translation of surgeon needs into design specifications through an exhaustive series of quality control checks that are performed through the purchasing, production, and packaging of our products. We record the complete production history for every product, ensuring full traceability from the raw material stage through the delivery of the product into the marketplace.

Following the receipt of products or product components that we receive from third parties, we conduct inspection, quality control, packaging and labeling, as needed, at our manufacturing facilities. The raw materials used in the manufacture of our products are principally titanium, titanium alloys, stainless steel, cobalt chrome, ceramic, allograft and PEEK. Invibio, Inc., or Invibio, is one of a limited number of companies that is currently approved in the U.S. to distribute PEEK for use in implantable devices.

With the exception of PEEK and tissue-based products, none of our raw material requirements is limited to any significant extent by critical supply. We are subject to the risk that Invibio will fail to supply PEEK in adequate amounts for our needs on a timely basis. In addition, because our biologics products are processed from human tissue, maintaining a steady supply can sometimes be challenging. See our risk factor entitled, "We depend on various third-party suppliers, and in one case a single third-party supplier, for key raw materials used in our manufacturing processes and the loss of these third-party suppliers, or their inability to supply us with adequate raw materials, could harm our business" in "Item 1A Risk Factors." Our manufacturing operations and those of the third-party manufacturers we use are subject to extensive regulation by the FDA and similar entities outside of the U.S. under its quality systems regulations, or QSRs, and other applicable device-related good manufacturing practices, or GMPs, or tissue-related tissue practices, or GTPs, and applicable local regulations. With respect to biologics products, we are FDA-registered and licensed in the states of California, New York and Florida, the only states that currently require licenses. Our

facility and the facilities of the third-party manufacturers we use are subject to periodic unannounced inspections by regulatory authorities, and may undergo compliance inspections conducted by the FDA and corresponding state and foreign agencies.

8

---



## Competition

Although we believe that our current broad product portfolio and development pipeline is differentiated and has numerous competitive advantages, the spinal implant industry is highly competitive, subject to rapid technological change, and significantly affected by new product introductions. We believe that the principal competitive factors in our market include:

- improved outcomes for spine pathology procedures;
- ease of use and reliability;
- effective sales, marketing and distribution;
- technical leadership and superiority;
- surgeon services, such as training and education;
- responsiveness and ability to develop unique products that address the needs of surgeons;
- manufacturing capabilities;
- acceptance by spine surgeons;
- product price and qualification for reimbursement; and
- speed to market.

Our currently marketed products are, and any future products we commercialize will be, subject to intense competition and we are aware of several companies that compete in our current and future product areas. We believe that our most significant competitors are Medtronic Sofamor Danek, Johnson & Johnson (DePuy/Synthes), Stryker, Biomet, NuVasive, Zimmer, Orthofix, Globus Medical, Integra Life Science, LDR Spine and others, many of which have substantially greater financial resources than we do. In addition, these companies may have more established distribution networks, entrenched relationships with physicians, and greater experience in developing, launching, marketing, distributing and selling spinal implant products.

Our competitors include providers of non-operative therapies for spine disorder conditions. While these non-operative treatments are considered to be an alternative to surgery, surgery is typically performed in the event that non-operative treatments are unsuccessful. We believe that, to date, these non-operative treatments have not caused a material reduction in the demand for surgical treatment of spinal disorders.

## Intellectual Property

We rely on a combination of patent, trademark, copyright, trade secret and other intellectual property laws, nondisclosure agreements, proprietary information ownership agreements and other measures to protect our intellectual property rights. We believe that in order to have a competitive advantage, we must develop, maintain and enforce the proprietary aspects of our technologies. We require our employees, consultants, co-developers, distributors and advisors to execute agreements governing the ownership of proprietary information and use and disclosure of confidential information in connection with their relationship with us. In general, these agreements require these people and entities to agree to disclose and assign to us all inventions that were conceived on our behalf or which relate to our property or business and to keep our confidential information confidential and only use such confidential information in connection with our business.

Despite any measures taken to protect our intellectual property, unauthorized parties may attempt to copy aspects of our products or to obtain and use information that we regard as proprietary. In addition, our competitors may independently develop similar technologies. Further, as described in "Item 3 Legal Proceedings," others may attempt to obtain royalties based on the net sales of our products or other payments from us, which may impact our revenues. We may lose market share to our competitors if we fail to protect our intellectual property rights.

## Patents

As of December 31, 2013, we and our affiliates owned 83 issued U.S. patents, 100 pending U.S. patent applications and 350 issued or pending foreign patents. We own multiple patents relating to unique aspects and improvements for several of our products. We do not believe that the expiration of any single patent is likely to significantly affect our intellectual property position.

The medical device industry is characterized by the existence of a large number of patents and frequent litigation based on allegations of patent infringement. Patent litigation can involve complex factual and legal questions and its outcome is uncertain. Any claim relating to infringement of patents that is successfully asserted against us may require

us to pay substantial damages (including treble damages if our infringement is found to be willful) or may require us to remove our

9

---

infringing product from the market. Even if we were to prevail, any litigation could be costly and time-consuming and would divert the attention of our management and key personnel from our business operations. Our success will also depend in part on our not infringing patents issued to others, including our competitors and potential competitors. If our products are found to infringe the patents of others, our development, manufacture and sale of such potential products could be severely restricted or prohibited. In addition, our competitors may independently develop similar technologies. We may lose market share to our competitors if we fail to protect our intellectual property rights.

As the number of entrants into our market increases, the possibility of a patent infringement claim against us grows. While we make an effort to ensure that our products do not infringe other parties' patents and proprietary rights, our products and methods may be covered by U.S. or foreign patents held by our competitors. In addition, our competitors may assert that future products we may manufacture or market infringe their patents.

If we are accused of patent infringement, we may be required to obtain licenses to patents or proprietary rights of others in order to continue to commercialize our products. However, we may not be able to obtain any licenses required under any patents or proprietary rights of third parties on acceptable terms, or at all. Even if we were able to obtain rights to the third party's intellectual property, these rights may be non-exclusive, thereby giving our competitors access to the same intellectual property. Ultimately, we may be unable to commercialize some of our potential products or may have to cease some of our business operations as a result of patent infringement claims, which could severely harm our business financial condition and results of operations.

#### Trademarks

As of December 31, 2013, we and our affiliates owned these registered U.S. trademarks: 3D ProFuse, Alphatec logo, Aging Spine Center, Alphagraft, Alphagraft Duofuse, Alphagraft Nanoblast, Alphagraft Profuse, Alphaguard, Alphatec Spine and logo, Alphatec MHS, Alphatec Nexoss, Alphatec Solus, Alphatec Solus and logo, Alphatec Spine, Amnioshield, Anchormax, ARC, Avalon, Bone'x, Bridgepoint, Chorus, Corelys, Del Mar, Deltaloc, Dynamic-TTL Rod, Easys, Electra, Elfix, Epicage, GLIF, Helifix, Illico, Isobar, Isobar Duo, Isobar Hemispherical Screw, Isobar LP, Isobar TTC, Isobar U-Screw, Laguna, Nexoss, Novel, Openview, Osseofix, Osseofix and logo, Osseofix+ and logo, Osseoscrew, Osseoscrew and logo, Pach, Pantheon, Pegasus, Samarys, Scient'x, Solutions for the Aging Spine, Stella, Tamarack, Trestle, Trestle Luxe, Tribeca, Scient'x logo, Xenon, and Zodiac.

#### License and Supply Agreements

As part of our product development strategy, when commercially feasible we enter into agreements with third parties that enable us to develop, commercialize and/or distribute products for the treatment of spinal disorders that are based upon technology owned by such third parties. Our key agreements are described in Note 5 to our consolidated financial statements under "Part II, Item 8 Financial Statements and Supplementary Data".

#### Elite Medical Holdings and Pac 3 Surgical Products Agreement

In October 2013, we entered into a three-year collaboration agreement with a third party to provide consultation services to assist us in the development of our products and our products in development. Under the terms of the collaboration agreement, we will gain exclusive rights to the use of all intellectual property developed by the collaborators. We will make three annual payments to the collaborator as sole consideration for services provided, totaling an aggregate of up to \$8 million, paid in our common stock at a per share price of \$1.95, which was equal to the average NASDAQ closing price of our common stock on the five days leading up to and including the date we signed the collaboration agreement. The actual number of shares issued each year will be determined by the fair market value of the services provided over the prior 12 months.

#### Government Regulation

Our products are subject to extensive regulation by the FDA and other U.S. federal and state regulatory bodies and comparable authorities in other countries. To ensure that medical products distributed domestically and internationally are safe and effective for their intended use, FDA and comparable authorities in other countries have imposed regulations that govern, among other things, the following activities that we or our partners perform and will continue to perform:

- product design and development;
- product testing;

product manufacturing;  
product labeling;

10

---

- product storage;
- premarket clearance or approval;
- advertising and promotion;
- product marketing, sales and distribution; and
- post-market surveillance, including reporting deaths or serious injuries related to products and certain product malfunctions.

#### FDA's Premarket Clearance and Approval Requirements

Unless an exemption applies, each medical device we wish to commercially distribute in the U.S. will require either prior 510(k) clearance or approval of a premarket approval application, or PMA. The information that must be submitted to the FDA in order to obtain clearance or approval to market a new medical device varies depending on how the medical device is classified by the FDA. Medical devices are classified into one of three classes on the basis of the intended use of the device, the risk associated with the use of the device for that indication, as determined by the FDA, and on the controls deemed by the FDA to be necessary to reasonably ensure their safety and effectiveness. Class I devices, which are those that have the lowest level of risk associated with them, are subject to general controls, Class II devices are subject to general controls and special controls, including performance standards, and Class III devices, which have the highest level of risk associated with them, are subject to general controls and premarket approval. Most Class I devices and many Class II devices are exempt from the 510(k) requirement, although the manufacturers will still be subject to registration, listing, labeling and GMP requirements. Class III devices are subject to those requirements and additional requirements including PMA approval. A new medical device for which there is no substantially equivalent device is automatically designated a Class III device. Depending on the nature of the new device, the manufacturer may ask the FDA to make a risk-based determination of the new device and reclassify it in Class I or Class II. This process is referred to as the de novo process. If the FDA agrees, the new device will be reassigned to the appropriate other class. If the FDA does not agree, the manufacturer will have to submit a PMA. Our current commercial products are Class II devices marketed under FDA 510(k) premarket clearance. Both 510(k)s and PMAs are subject to the payment of user fees at the time of submission for FDA review.

#### 510(k) Clearance Pathway

To obtain 510(k) clearance, we must submit a premarket notification demonstrating that the proposed device is substantially equivalent to a device legally marketed in the U.S. for which a PMA was not required. The FDA's goal is to review and act on each 510(k) within 90 days of submission, but it may take longer if they request additional information. Most 510(k)s do not require supporting data from clinical trials, but the FDA may request such data. After a device receives 510(k) clearance, any modification that could significantly affect its safety or effectiveness, or that would constitute a new or major change in its intended use, will require a new 510(k) clearance or, depending on the modification, require premarket approval. Each manufacturer initially determines whether the proposed change requires submission of a 510(k), or a premarket approval, but the FDA can review any such decision and can disagree with a manufacturer's determination. If the FDA disagrees with a manufacturer's determination, the FDA can require the manufacturer to cease marketing and/or recall the modified device until 510(k) clearance or premarket approval is obtained. If the FDA requires us to seek 510(k) clearance or premarket approval for any modifications to a previously cleared product, we may be required to cease marketing or recall the modified device until we obtain this clearance or approval. Also, in these circumstances, we may be subject to significant fines or penalties. We have made and plan to continue to make enhancements to our products, and we will consider on a case-by-case basis whether a new 510(k) or PMA is necessary.

#### Premarket Approval Pathway

A PMA must be submitted if the device cannot be cleared through the 510(k) process. The PMA process is generally more complex, costly and time consuming than the 510(k) process. A PMA must be supported by extensive data including, but not limited to, technical, preclinical, clinical trials, manufacturing and labeling to demonstrate to the FDA's satisfaction the safety and effectiveness of the device for its intended use.

After a PMA is sufficiently complete, the FDA will accept the application for filing and begin an in-depth review of the submitted information. By statute, the FDA has 180 days to review the accepted application, although, review of the application generally can take between one and three years. During this review period, the FDA may request

additional information or clarification of information already provided. Also during the review period, an advisory panel of experts from outside the FDA may be convened to review and evaluate the application and provide recommendations to the FDA as to the approvability of the device. In addition, the FDA will conduct a preapproval inspection of the manufacturing facility to ensure compliance with

quality system regulations, or QSRs. New premarket approval applications or premarket approval application supplements are also required for product modifications that affect the safety and efficacy of the device. Premarket approval supplements often require submission of the same type of information as a PMA, except that the supplement is limited to information needed to support any changes from the device covered by the original PMA approval, and may not require clinical data or the convening of an advisory panel. We were not required to submit a PMA for any of our currently marketed products, but devices in development may require a PMA.

#### Clinical Trials

Clinical trials are usually required to support a PMA and are sometimes required for a 510(k). In the U.S., if the device is determined to present a “significant risk,” the manufacturer may not begin a clinical trial until it submits an investigational device exemption application, or IDE, and obtains approval of the IDE from the FDA. The IDE must be supported by appropriate data, such as animal and laboratory testing results, showing that it is safe to test the device in humans and that the testing protocol is scientifically sound. These clinical trials are also subject to the review, approval and oversight of an institutional review board, or IRB, at each clinical trial site. The clinical trials must be conducted in accordance with FDA’s IDE regulations and international regulations concerning human subject protection. A clinical trial may be suspended by FDA, the sponsor or an IRB at any time for various reasons, including a belief that the risks to the study participants outweigh the benefits of participation in the trial. Even if a clinical trial is completed, the results may not demonstrate the safety and efficacy of a device to the satisfaction of the FDA, or may be equivocal or otherwise not be sufficient to obtain approval of a device.

#### Pervasive and Continuing FDA Regulation

After a device is placed on the market, numerous FDA and other regulatory requirements continue to apply. These include:

- quality system regulations, which require manufacturers, including third-party contract manufacturers, to follow stringent design, testing, control, documentation, record maintenance and other quality assurance controls, during all aspects of the manufacturing process and to maintain and investigate complaints;
- labeling regulations, and FDA prohibitions against the promotion of products for uncleared or unapproved “off-label” uses;
- medical device reporting obligations, which require that manufacturers submit reports to the FDA of adverse events; and
- other post-market surveillance requirements, which apply when necessary to protect the public health or to provide additional safety and effectiveness data for the device.

Failure to comply with applicable regulatory requirements can result in enforcement action by the FDA, which may include any of the following:

- warning letters;
- fines, injunctions, and civil penalties;
- recall or seizure of products;
- operating restrictions, partial suspension or total shutdown of production;
- refusal to grant 510(k) clearance or PMA approvals of new products; and
- criminal prosecution.

To ensure compliance with regulatory requirements, medical device manufacturers are subject to market surveillance and manufacturers and their third-party manufacturers are subject to periodic announced and unannounced inspections by the FDA.

In June 2011, the FDA sent an untitled letter to the manufacturer of our PureGen product, Parcell Laboratories, LLC, regarding the regulatory status of the product. In the letter, the FDA raised questions in connection with Parcell’s position that the PureGen product is a human cell, tissue, and cellular or tissue-based product regulated solely under Section 361 of the Public Health Service Act and 21 C.F.R, Part 1271, and is not subject to any premarket review requirements. Parcell responded to the FDA’s letter in July 2011 with additional information about PureGen supporting its belief that the product qualifies as a Section 361 product. A formal request for designation of the regulatory status of PureGen was submitted in January 2013, and in February 2013, we voluntarily stopped shipping PureGen based on our decision not to pursue getting regulatory approval of PureGen as a biologic. In response to the formal request for

designation by Parcell, the FDA responded on August 7, 2013, confirming their position that PureGen is a biologic and not regulated under Section 361 of the Public Health Service Act and 21 C.F.R, Part 1271.



### International Device Regulations

International sales of medical devices are subject to foreign government regulations, which vary substantially from country to country. The time required to obtain approval by a foreign country may be longer or shorter than that required for FDA approval, and the requirements may differ.

#### Japan

In Japan, certain medical devices classified as “highly controlled” must be approved prior to importation and commercial sale by the Ministry of Health, Labour and Welfare, or MHLW, pursuant to the Japanese Pharmaceutical Affairs Law. Manufacturers of medical devices outside of Japan which do not operate through a Japanese entity are required to appoint a contractually bound authorized representative to directly submit an application for device approval to the MHLW. The MHLW evaluates each device for safety and efficacy and may require that the product be tested in Japanese laboratories. After a device is approved for importation and commercial sale in Japan, the MHLW continues to monitor sales of approved products for compliance. Failure to comply with applicable regulatory requirements can result in enforcement action by the MHLW, including administrative inspections and recommendations; recall or seizure of products; operating restrictions, including partial suspension or total shut down of marketing activity in Japan; withdrawal of product approvals; and criminal prosecution by a public prosecutor, including criminal fines and/or imprisonment.

Our devices fall into the “highly controlled” medical device category. Currently, MHLW review times for our device applications range from one year if clinical data is not required, to up to two years if clinical data is required. The review times for our products are expected to be reduced to six months and one year, respectively, and we expect application fees to be reduced as new approval screening standards are established by the MHLW, which has delegated responsibility for these review functions to the Japanese Pharmaceuticals and Medical Devices Agency, for various medical device categories. Currently, the MHLW is working with trade organizations such as AdvaMed, and MHLW may adopt similar standards.

#### European Union

The European Union, which consists of 27 of the countries in Europe, has adopted numerous directives and standards regulating the design, manufacture, clinical trials, labeling, and adverse event reporting for medical devices. Other countries, such as Switzerland, have voluntarily adopted laws and regulations that mirror those of the European Union with respect to medical devices. Devices that comply with the requirements of a relevant directive will be entitled to bear CE conformity marking and, accordingly, can be commercially distributed throughout the member states of the European Union, as well as other countries that comply with or mirror these directives. The method of assessing conformity varies depending on the type and class of the product, but normally involves a combination of self-assessment by the manufacturer or a third-party assessment by a “Notified Body,” an independent and neutral institution appointed to conduct conformity assessment. This third-party assessment consists of an audit of the manufacturer’s quality system and technical review and testing of the manufacturer’s product. An assessment by a Notified Body in one country within the European Union is required in order for a manufacturer to commercially distribute the product throughout the European Union. In addition, compliance with voluntary harmonized standards including ISO 13845 issued by the International Organization for Standards establishes the presumption of conformity with the essential requirements for a CE mark. In October 2007, we were certified by Intertek Semko, a Notified Body, under the European Union Medical Device Directive allowing the CE conformity marking to be applied. In September 2012, the European Commission adopted a proposal for a regulation which if adopted will change the way that most medical devices are regulated in the European Union, and may subject our products to additional requirements.

#### Environmental Matters

Our facilities and operations are subject to extensive federal, state, and local environmental and occupational health and safety laws and regulations. These laws and regulations govern, among other things, air emissions; wastewater discharges; the generation, storage, handling, use and transportation of hazardous materials; the handling and disposal of hazardous wastes; the cleanup of contamination; and the health and safety of our employees. Under such laws and regulations, we are required to obtain permits from governmental authorities for some of our operations. If we violate or fail to comply with these laws, regulations or permits, we could be fined or otherwise sanctioned by regulators. We

could also be held responsible for costs and damages arising from any contamination at our past or present facilities or at third-party waste disposal sites. We cannot completely eliminate the risk of contamination or injury resulting from hazardous materials, and we may incur material liability as a result of any contamination or injury.

**Compliance with Fraud and Abuse Laws and Other Applicable Statutes**

We are subject to various federal and state laws pertaining to healthcare fraud and abuse, including anti-kickback laws, physician self-referral laws, false claims laws, criminal health care fraud laws, and foreign corrupt practice laws. Violations of

these laws are punishable by criminal and/or civil sanctions, including, in some instances, fines, imprisonment and, within the United States, exclusion from participation in government healthcare programs, including Medicare, Medicaid and Veterans Administration health programs. These laws are administered by, among others, the U.S. Department of Justice, the Office of Inspector General of the Department of Health and Human Services and state attorneys general. Many of these agencies have increased their enforcement activities with respect to medical device manufacturers in recent years.

The federal Anti-Kickback Statute, prohibits persons from knowingly and willfully soliciting, offering, receiving or providing remuneration, directly or indirectly, in exchange for or to induce either the referral of an individual, or the furnishing, arranging for or recommending a good or service, for which payment may be made in whole or part under federal healthcare programs, such as the Medicare and Medicaid programs. The Anti-Kickback Statute is broad and prohibits many arrangements and practices that are lawful in businesses outside of the healthcare industry. For example, the definition of "remuneration" has been broadly interpreted to include anything of value, including, gifts, discounts, the furnishing of supplies or equipment, credit arrangements, payments of cash, waivers of payments, ownership interests and providing anything at less than its fair market value. In addition, in March 2010, the U.S. Congress adopted and President Obama signed into law the Patient Protection and Affordable Health Care Act, which, as amended by the Health Care and Education Reconciliation Act, is referred to as ACA. ACA, among other things, amends the intent requirement of the federal Anti-Kickback Statute. A person or entity no longer needs to have actual knowledge of this statute or specific intent to violate it. In addition, ACA provides that the government may assert that a claim including items or services resulting from a violation of the Anti-Kickback Statute constitutes a false or fraudulent claim for purposes of the federal False Claims Act.

In implementing the Anti-Kickback Statute, the Office of Inspector General, or OIG, has issued a series of regulations, known as the safe harbors, which began in July 1991. These safe harbors set forth provisions that, in circumstances where all the applicable requirements are met, will assure healthcare providers and other parties that they will not be prosecuted under the Anti-Kickback Statute. The failure of a transaction or arrangement to fit precisely within one or more safe harbors does not necessarily mean that it is illegal or that prosecution will be pursued. However, conduct and business arrangements that do not fully satisfy all requirements of an applicable safe harbor may result in increased scrutiny by government enforcement authorities such as the OIG. Penalties for violations of the Anti-Kickback Statute include criminal penalties and civil sanctions such as fines, imprisonment and possible exclusion from Medicare, Medicaid and other federal healthcare programs. Many states have anti-kickback laws that are similar to the federal law, including penalties, fines, sanctions for violations, and exclusions from state or commercial programs.

The federal ban on physician self-referrals, commonly known as the Stark Law, prohibits, subject to certain exceptions, physician referrals of Medicare and Medicaid patients to an entity providing certain "designated health services" if the physician or an immediate family member of the physician has any financial relationship with the entity. Penalties for violating the Stark Law include fines, civil monetary penalties and possible exclusion from federal healthcare programs. In addition to the Stark Law, many states have their own self-referral laws. Often, these laws closely follow the language of the federal law, although they do not always have the same scope, exceptions or safe harbors.

We have entered into various agreements with certain surgeons that perform services for us, including some who make clinical decisions to use our products. Some of our referring surgeons own our stock, which they either purchased in an arms' length transaction on terms identical to those offered to non-surgeons or received from us as fair market value consideration for services performed. All such arrangements have been structured with the intention of complying with all applicable fraud and abuse laws, including the Anti-Kickback Statute, Stark Law and similar state self-referral laws. In addition, physician-owned distribution companies, or PODs, have increasingly become involved in the sale and distribution of medical devices, including products for the surgical treatment of spine disorders. In many cases, these distribution companies enter into arrangements with hospitals that bill Medicare or Medicaid for the furnishing of medical services, and the physician-owners are among the physicians who refer patients to the hospitals for surgery. On March 26, 2013 the OIG issued a Special Fraud Alert entitled "Physician-Owned Entities", or the Fraud Alert, in which the OIG concluded, among other things, that PODs are "inherently suspect under the

anti-kickback statute" and that PODs present "substantial fraud and abuse risk and pose dangers of patient safety." We believe that all of our arrangements with PODs comply with applicable fraud and abuse laws and do not believe that we are subject to any arrangements that violate any such laws.

The federal False Claims Act prohibits persons from knowingly filing or causing to be filed a false or fraudulent claim to, or the knowing use of false statements to obtain payment from, the federal government. Private suits filed under the False Claims Act, known as qui tam actions, can be brought by individuals on behalf of the government. These individuals, sometimes known as "relators" or, more commonly, as "whistleblowers," may share in any amounts paid by the entity to the government in fines or settlement. The number of filings of qui tam actions has increased significantly in recent years, causing more healthcare companies to have to defend a False Claim Act action. If an entity is determined to have violated the federal False Claims Act, it may be required to pay up to three times the actual damages sustained by the government, plus civil penalties of between \$5,500 to \$11,000 for each separate false claim and may be subject to exclusion from Medicare, Medicaid and other federal healthcare programs. Various states have also enacted similar laws modeled after the federal False Claims Act

which apply to items and services reimbursed under Medicaid and other state programs, or, in several states, apply regardless of the payor.

The Health Insurance Portability and Accountability Act, or HIPAA, created two new federal crimes: healthcare fraud and false statements relating to healthcare matters. The healthcare fraud statute prohibits knowingly and willfully executing a scheme to defraud any healthcare benefit program, including private payors. Under recent changes in ACA, the intent requirement of the healthcare fraud statute is lowered such that a person or entity no longer needs to have actual knowledge of this statute or specific intent to violate it. A violation of this statute is a felony and may result in fines, imprisonment or possible exclusion from Medicare, Medicaid and other federal healthcare programs. The false statements statute prohibits knowingly and willfully falsifying, concealing or covering up a material fact or making any materially false, fictitious or fraudulent statement in connection with the delivery of or payment for healthcare benefits, items or services. A violation of this statute is a felony and may result in similar sanctions.

ACA also includes various provisions designed to strengthen significantly fraud and abuse enforcement in addition to those changes discussed above. Among these additional provisions include increased funding for enforcement efforts and new “sunshine” provisions to require us to report and disclose to the Centers for Medicare and Medicaid Services, or CMS, any payment or “transfer of value” made or distributed to physicians or teaching hospitals. These sunshine provisions also require certain group purchasing organizations, including physician-owned distributors, to disclose physician ownership information to CMS. On February 8, 2013, CMS published a detailed regulation implementing these sunshine provisions. Under this final rule, starting August 1, 2013, the company and other device manufacturers collected specific data on payments and other transfers of value to physicians and teaching hospitals for the remaining calendar year 2013, with such data to be assembled into a report due to CMS by March 31, 2014, and annually thereafter. CMS will then publish on its website all manufacturer reports of such payments and transfers of value.

There are various state laws and initiatives that require device manufacturers to disclose to the appropriate regulatory agency certain payments or other transfers of value made to physicians, and in certain cases prohibit some forms of these payments, with the risk of fines for any violation of such requirements. Massachusetts has one of the most stringent of these laws, and the District of Columbia and Vermont passed such laws in 2008 and 2009, respectively. HIPAA also includes privacy and security provisions designed to regulate the use and disclosure of “protected health information” or “PHI” which is health information that identifies a patient and that is held by a health care provider, a health plan or health care clearinghouse. We are not directly regulated by HIPAA, but our ability to access PHI for purposes such as marketing, product development, clinical research or other uses is controlled by HIPAA and restrictions placed on health care providers and other covered entities. HIPAA was amended in 2009 by the Health Information Technology for Economic and Clinical Health Act (HITECH) which strengthened the rule, increased penalties for violations and added a requirement for the disclosure of breaches to affected individuals, the government and in some cases the media. We must carefully structure any transaction involving PHI to avoid violation of HIPAA and HITECH requirements.

Almost all states have adopted data security laws protecting personal information including social security numbers, state issued identification numbers, credit card or financial account information coupled with individuals’ names or initials. We must comply with all applicable state data security laws, even though they vary extensively, and must ensure that any breaches or accidental disclosures of personal information are promptly reported to affected individuals and responsible government entities. We must also ensure that we maintain compliant, written information security programs or run the risk of civil or even criminal sanctions for non-compliance as well as reputational harm for publicly reported breaches or violations.

We may also be exposed to liabilities under the U.S. Foreign Corrupt Practices Act, or FCPA, which generally prohibits companies and their intermediaries from making corrupt payments to foreign officials for the purpose of obtaining or maintaining business or otherwise obtaining favorable treatment, and requires companies to maintain adequate record-keeping and internal accounting practices to accurately reflect the transactions of the company. We are also subject to a number of other laws and regulations relating to money laundering, international money transfers and electronic fund transfers. These laws apply to companies, individual directors, officers, employees and agents. If any of our operations are found to have violated or be in violation of any of the laws described above and other applicable state and federal fraud and abuse laws, we may be subject to penalties, among them being civil and

criminal penalties, damages, fines, exclusion from government healthcare programs, and the curtailment or restructuring of our operations.

**Third-Party Reimbursement**

In the U.S., healthcare providers generally rely on third-party payors, principally private insurers and governmental payors such as Medicare and Medicaid, to cover and pay for all or part of the cost of a spine surgery in which our medical devices are used. We expect that sales volumes and prices of our products will depend in large part on the continued availability of reimbursement from such third-party payors. These third-party payors may deny reimbursement if they determine that a

device used in a procedure was not medically necessary in accordance with cost-effective treatment methods, as determined by the third-party payor, or was used for an unapproved indication. Particularly in the U.S., third-party payors continue to carefully review, and increasingly challenge, the prices charged for procedures and medical products.

Medicare coverage and reimbursement policies are developed by CMS, the federal agency responsible for administering the Medicare program, and its contractors. CMS establishes these Medicare policies for medical products and procedures and such policies are periodically reviewed and updated. While private payors vary in their coverage and payment policies, the Medicare program is viewed as a benchmark. Medicare payment rates for the same or similar procedures vary due to geographic location, nature of the facility in which the procedure is performed (i.e., teaching or community hospital) and other factors. We cannot assure you that government or private third-party payors will cover and provide adequate payment for the procedures in which our products are used.

ACA and other reform proposals contain significant changes regarding Medicare, Medicaid and other third party payors. Among these changes was the imposition of a 2.3% excise tax on domestic sales of medical devices that went into effect on January 1, 2013. These taxes have resulted in a significant increase in the tax burden on our industry. Other elements of this legislation include numerous provisions to limit Medicare spending through reductions in various fee schedule payments and by instituting more sweeping payment reforms, such as bundled payments for episodes of care, the establishment of “accountable care organizations” under which hospitals and physicians will be able to share savings that result from cost control efforts, comparative effectiveness research, value-based purchasing, and the establishment of an independent payment advisory board. Many of these provisions have been implemented through the regulatory process. In addition, in June 2012 the United States Supreme Court upheld the constitutionality of the minimum essential health insurance coverage rule, or so-called personal mandate, while holding that the federal government must give states the option to accept ACA’s Medical expansion provisions without risk of losing all federal Medicaid funds. Pursuant to that ruling, several states have declined to expand Medicaid coverage. For those states, the failure to expand its Medicaid program as prescribed in ACA will restrict the ability of populations potentially served by such expansion to use our products. Other proposals have been introduced in Congress to repeal the device tax and various healthcare reform proposals have also emerged at the state level. An expansion in government’s role in the U.S. healthcare industry may lower reimbursements for our products, reduce medical procedure volumes, and adversely affect our business and results of operations, possibly materially.

Internationally, healthcare payment systems vary substantially from country to country and include single-payor, government-managed systems as well as systems in which private payors and government-managed systems exist side-by-side. Our ability to achieve market acceptance or significant sales volume in international markets we enter will be dependent in large part on the availability of reimbursement for procedures performed using our products under the healthcare payment systems in such markets. A small number of countries may require us to gather additional clinical data before covering our products. It is our intent to complete the requisite clinical studies and obtain coverage in countries where it makes economic sense to do so.

We believe that the overall escalating cost of medical products and services has led to, and will continue to lead to, increased pressures on the healthcare industry to reduce the costs of products and services. We cannot assure you that government or private third-party payors will cover and provide adequate payment for the procedures using our products. In addition, it is possible that future legislation, regulation, or reimbursement policies of third-party payors will adversely affect the demand for procedures using our products or our ability to sell our products on a profitable basis. The unavailability or inadequacy of third-party payor coverage or reimbursement could have a significant adverse effect on our business, operating results and financial condition.

#### Employees

As of December 31, 2013, we had approximately 500 employees worldwide in the following areas: sales, customer service, marketing, clinical education, manufacturing, advanced manufacturing, quality assurance, regulatory affairs, research and development, human resources, finance, legal, information technology and administration. We have never experienced a work stoppage due to labor difficulties and believe that our relations with our employees are good. Certain employees in Europe have labor committees and collective bargaining agreements in place. On September 16, 2013, we announced that our French subsidiary, Scient’x S.A.S. and its subsidiary Surgiview S.A.S.

had begun a process aimed at significantly restructuring its business operations. The restructuring includes a reduction in Scient'x's workforce in 2014, and when completed in accordance with French laws, is expected to affect 76 positions.



## Corporate and Available Information

We are a Delaware corporation. We were incorporated in March 2005. Our principal executive office is located at 5818 El Camino Real, Carlsbad, California 92008. Our Internet address is [www.alphatecspine.com](http://www.alphatecspine.com). By referring to our website, we do not incorporate the website or any portion of the website by reference into this Annual Report on Form 10-K. We are not including the information contained on our website as a part of, or incorporating it by reference into, this Annual Report on Form 10-K. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports, are available to you free of charge through the Investor Relations section of our website as soon as reasonably practicable after such materials have been electronically filed with, or furnished to, the Securities and Exchange Commission, or SEC.

### Item 1A. Risk Factors

Investing in our common stock involves a high degree of risk. You should carefully consider the following risk factors and all other information contained in this Annual Report on Form 10-K. The risks and uncertainties described below are not the only ones facing us. Additional risks and uncertainties that we are unaware of, or that we currently deem immaterial, also may become important factors that affect us. If any of such risks or the risks described below, either alone or taken together, occur, our business, financial condition or results of operations could be materially and adversely affected. In that case, the trading price of our common stock could decline, and you may lose some or all of your investment.

#### Risks Related to Our Business and Industry

Our business plan relies on certain assumptions pertaining to the market for our products that, if incorrect, may adversely affect our growth and profitability.

We allocate our design, development, manufacturing, marketing, management and financial resources based on our business plan, which includes assumptions about various demographic trends and trends in the treatment of spine disorders and the resulting demand for our products. However, these trends are uncertain. There can be no assurance that our assumptions with respect to an aging population with broad medical coverage and longer life expectancy, which we expect to lead to increased spinal injuries and degeneration, are accurate. In addition, an increasing awareness and use of non-invasive means for the prevention and treatment of back pain and rehabilitation purposes may reduce demand for, or slow the growth of sales of, spine fusion products. A significant shift in technologies or methods used in the treatment of back pain or damaged or diseased bone and tissue could adversely affect demand for some or all of our products. For example, pharmaceutical advances could result in non-surgical treatments gaining more widespread acceptance as a viable alternative to spine fusion. The emergence of new biological or synthetic materials to facilitate regeneration of damaged or diseased bone and to repair damaged tissue could increasingly minimize or delay the need for spine fusion surgery and provide other biological alternatives to spine fusion. New surgical procedures could diminish demand for some of our products. The increased acceptance of emerging technologies that do not require spine fusion, such as artificial discs and nucleus replacement, for the surgical treatment of spine disorders would reduce demand for, or slow the growth of sales of, spine fusion products. If our assumptions regarding these factors prove to be incorrect or if alternative treatments to those offered by our products gain further acceptance, then actual demand for our products could be significantly less than the demand we anticipate for our products and we may not be able to achieve or sustain growth or profitability.

If we fail to properly manage our anticipated growth, our business could suffer.

We will continue to pursue growth in, the number of surgeons using our products, including, without limitation the surgeon members of Phygen, the types of products we offer and the geographic regions in which our products are sold. Such anticipated growth has placed and will continue to place significant demands on our managerial, operational and financial resources and systems. Future growth would impose significant added responsibilities on members of management, including the need to identify, recruit, maintain, motivate and integrate additional personnel. Also, our management may need to divert a disproportionate amount of its attention away from our day-to-day activities and devote a substantial amount of time to managing these anticipated growth activities. We are currently focused on increasing the size and effectiveness of our sales force and distribution network, marketing activities, research and development efforts, inventory management systems, management team and corporate infrastructure. If we do not manage our anticipated growth effectively, the quality of our products, our relationships

with physicians, including the surgeon members of Phygen, distributors and hospitals, and our reputation could suffer, which would have a significant adverse effect on our business, financial condition and results of operations. We must attract and retain qualified personnel and third-party distributors and manage and train them effectively. Personnel qualified in the design, development, production and marketing of our products are difficult to find and hire, and enhancements of information technology systems to support our growth are difficult to implement. We will also need to carefully monitor and manage our surgeon services, our manufacturing capabilities, quality assurance and efficiency, and the quality assurance and efficiency of our suppliers and distributors. This managing, training and monitoring will require

allocation of valuable management resources and significant expense. If our management is unable to effectively manage our expected growth, our expenses may increase more than expected, our ability to generate and/or grow revenues could be reduced and we may not be able to implement our business strategy.

We are in a highly competitive market segment, face competition from large, well-established medical device companies with significant resources, and may not be able to compete effectively.

The market for spine fusion products and procedures is intensely competitive, subject to rapid technological change and significantly affected by new product introductions and other market activities of industry participants. In 2013, a large percentage of global spine implant product revenues was generated by Medtronic Sofamor Danek, a subsidiary of Medtronic, Inc., Depuy Spine, a subsidiary of Johnson & Johnson, and Stryker Spine. Our competitors also include numerous other publicly-traded and privately-held companies.

Several of our competitors enjoy competitive advantages over us, including:

- more established relationships with spine surgeons;
- more established distribution networks;
- broader spine surgery product offerings;
- stronger intellectual property portfolios;
- greater financial and other resources for product research and development, sales and marketing, and patent litigation;
- greater experience in, and resources for, launching, marketing, distributing and selling products;
- significantly greater name recognition as well as more recognizable trademarks for products similar to the products that we sell;
- more established relationships with healthcare providers and payors;
- products supported by more extensive clinical data; and
- greater experience in obtaining and maintaining FDA and other regulatory clearances or approvals for products and product enhancements.

In addition, at any time our current competitors or other companies may develop alternative treatments, products or procedures for the treatment of spine disorders that compete directly or indirectly with our products, including ones that prove to be superior to our spine surgery products. For these reasons, we may not be able to compete successfully against our existing or potential competitors. Any such failure could lead us to modify our strategy, lower our prices, increase the commissions we pay on sales of our products and have a significant adverse effect on our business, financial condition and results of operations.

We expect to incur costs and charges as a result of the restructuring of our French operations and workforce reductions that we expect will reduce on-going costs, and those measures also may be disruptive to our business and may not result in anticipated cost savings.

In the third quarter of 2013, we initiated a restructuring of our French Operations, and such restructuring will have a negative impact on revenues, and we might not realize the financial benefits of such restructuring.

On September 16, 2013, we announced that our French subsidiary, Scient'x S.A.S. and its subsidiary Surgiview S.A.S., had begun a process aimed at significantly restructuring its business operations. The restructuring includes a reduction in the French workforce, and when completed in accordance with French laws, is expected to affect 76 positions. As a result of the restructuring, we estimate it will reduce operating expenditures by between \$2 to \$6 million on an annualized basis. We have recorded a restructuring charge accrual in accrued expenses of \$9.2 million within the consolidated balance sheets as of December 31, 2013, and restructuring expenses within the consolidated statements of operations for the year ending December 31, 2013. At December 31, 2013, we evaluated the impact that this restructuring will have on inventory and certain intangible assets including goodwill and will continue to evaluate as the restructuring is completed. There can be no assurance that we will be able to successfully complete the restructuring of our French operations or that we will be able to reduce our operating expenditures by the amounts that we expect, or at all, as a result of the restructuring. We may not be able to realize multi-year reductions in operating expense or yield improvements in international gross margins over operating margins as a result of the French restructuring and we may be unable to accurately forecast the restructuring costs associated with the implementation of the restructuring. Furthermore, such actions may be disruptive to our business. In connection with the restructuring we announced our intention to stop sales activities in the French market. The end of sales into the French market will

have a negative impact on our revenues. The restructuring may result in production inefficiencies, product quality issues, late product deliveries or lost orders, which would adversely impact our sales levels in areas in addition to France, operating results and

18

---

operating margins, and there can be no assurance that we will be able to provide Scient'x's customers, distributors, and suppliers with immediate and long-term benefits following the French restructuring.

A significant percentage of our revenues are derived from the sale of our systems that include polyaxial pedicle screws.

Net sales of our systems that include polyaxial pedicle screws represented approximately 47% and 45% of our net sales for 2013 and 2012, respectively. A decline in sales of these systems, due to market demand, the introduction by a third party of a competitive product, an intellectual property dispute involving these systems, or otherwise, would have a significant adverse impact on our business, financial condition and results of operations. Some of the technology related to our polyaxial pedicle screw systems is licensed to us. Any action that would prevent us from manufacturing, marketing and selling our polyaxial pedicle screw systems would have a significant adverse effect on our business, financial condition and results of operations.

Our sales and marketing efforts in the U.S. are largely dependent upon third parties, some of which are free to market products that compete with our products.

Certain of our independent distributors in the U.S. also market and sell the products of our competitors, and those competitors may have the ability to influence the products that our independent distributors choose to market and sell. Our competitors may be able, by offering higher commission payments or otherwise, to convince our independent distributors to terminate their relationships with us, carry fewer of our products or reduce their sales and marketing efforts for our products.

We may be unable to accurately predict future sales through distributors that purchase products directly from us, which could harm our ability to forecast sales performance.

A portion of our sales are made through domestic and international third-party distributors that purchase our products directly from us and then resell such products to hospitals. As a result, our financial results, quarterly product sales, trends and comparisons are affected by fluctuations in the buying patterns and inventory levels of these distributors. While we attempt to assist such distributors in forecasting its future sales and maintaining adequate inventory levels, we may not be consistently accurate or successful. In addition, our distributors' decision-making process regarding orders is complex and involves several factors, including surgeon demand levels, which can make it difficult to accurately predict our sales until late in a quarter. Our failure to accurately forecast sales through distributors that purchase products directly from us and the failure of such distributors to maintain adequate inventory levels could lead to a decline in sales and adversely affect our results of operations.

If pricing pressures cause us to decrease prices for our goods and services and we are unable to compensate for such reductions through changes in our product mix or reductions to our expenses, our results of operations will suffer.

We may experience decreasing prices for our goods and services we offer due to pricing pressure exerted by our customers in response to increased cost containment efforts from managed care organizations and other third-party payors and increased market power of our customers as the medical device industry consolidates. If we are unable to offset such price reductions through changes in our product mix or reductions in our expenses, our business, financial condition, results of operations and cash flows will be adversely affected.

We conduct a significant amount of our sales activity outside of the U.S., which subjects us to additional business risks and may adversely affect our results of operations and financial condition.

During the year ended December 31, 2013, we derived \$69.8 million, or 34% of our net sales from sales of products outside of the U.S. We intend to continue to pursue growth opportunities in sales internationally, which could expose us to additional risks associated with international sales and operations. Our international operations are, and will continue to be, subject to a number of risks and potential costs, including:

- the negative perception related to the French reorganization;
- ending sales activities in France;
- changes in foreign medical reimbursement policies and programs;
- changes in foreign regulatory requirements;
- differing local product preferences and product requirements;
- diminished protection of intellectual property in some countries outside of the U.S.;
- differing payment cycles;

trade protection measures and import or export licensing requirements;

19

---

• difficulty in staffing, training and managing foreign operations;  
• differing legal requirements and labor relations;  
• potentially negative consequences from changes in tax laws (including potentially taxes payable on earnings of foreign subsidiaries upon repatriation); and  
• political and economic instability.

In addition, we are subject to risks arising from currency exchange rate fluctuations, which could decrease our revenues, increase our costs and may adversely affect our results of operations. Significant increases in the value of the U.S. dollar relative to foreign currencies could have a material adverse effect on our international results of operations.

To be commercially successful, we must convince the spine surgeon community that our products are an attractive alternative to our competitors' products. If the spine surgeon community does not use our products, our sales will decline and we will be unable to increase our sales and profits.

In order for us to sell our products, surgeons must be convinced that they are superior to competing products. Acceptance of our products depends on educating the spine surgeon community as to the distinctive characteristics, perceived benefits, safety and cost-effectiveness of our products compared to our competitors' products and on training surgeons in the proper application of our products. If we are not successful in convincing the spine surgeon community of the merit of our products, our sales will decline and we will be unable to increase our sales and will be unable to achieve and sustain growth or profitability.

There is a learning process involved for spine surgeons to become proficient in the use of our products. Although most spine surgeons may have adequate knowledge on how to use most of our products based on their clinical training and experience, we believe that the most effective way to introduce and build market demand for our products is by directly training spine surgeons in the use of our products. If surgeons are not properly trained, they may misuse or ineffectively use our products. This may also result in unsatisfactory patient outcomes, patient injury, negative publicity or lawsuits against us, any of which could have a significant adverse effect on our business, financial condition and results of operations.

We must retain the current distributors of our products and attract new distributors of our products.

As we launch new products and increase our marketing efforts with respect to existing products, we will need to expand our sales and marketing organization. We plan to accomplish this by increasing our network of independent distributors and hiring additional direct sales representatives. The establishment and development of a broader sales network and dedicated sales force may be expensive and time consuming. Because of the intense competition for their services, we may be unable to recruit or retain additional qualified independent distributors and to hire additional direct sales representatives to work with us. Often, our competitors enter into distribution agreements with independent distributors that require such distributors to exclusively sell the products of our competitors. Further, we may not be able to enter into agreements with independent distributors on commercially reasonable terms, if at all. Even if we do enter into agreements with additional independent distributors, it often takes 90 to 120 days for new distributors to reach full operational effectiveness and such distributors may not generate revenue as quickly as we expect them to, commit the necessary resources to effectively market and sell our products or ultimately be successful in selling our products. Our business, financial condition and results of operations will be materially adversely affected if we do not retain our existing independent distributors and attract new, additional independent distributors or if the marketing and sales efforts of our independent distributors and our own direct sales representatives are unsuccessful.

We may not be successful in manufacturing products at the levels required to meet future market demand.

We are seeking to grow sales of our products and if we are successful, such growth may strain our ability to manufacture an increasingly large supply of our products. We have never produced products in quantities significantly in excess of our current production levels. Manufacturers regularly experience difficulties in scaling up production and we may face such difficulties in increasing our production levels. Moreover, we may not be able to manufacture our products with consistent and satisfactory quality or in sufficient quantities to meet demand. Our failure to produce products of satisfactory quality or in sufficient quantities could hurt our reputation; cause hospitals, surgeons or distributors to cancel orders or refrain from placing new orders for our products; and reduce or slow growth of sales of

our products. Increases in our production volume also could make it harder for us to maintain control over expenses, manage our relationships with our suppliers, maintain good relations with our employees or otherwise manage our business. In addition, should we not be able to achieve our revenue forecast and cash consumption starts to exceed forecasted consumption, management will need to adjust our production of surgical instruments and manage our inventory to the decreased sales volumes. If we do not make these adjustments in a timely manner, there could be an adverse impact on our financial resources.



We depend on various third-party suppliers, and in one case a single third-party supplier, for key raw materials used in our manufacturing processes and the loss of these third-party suppliers, or their inability to supply us with adequate raw materials, could harm our business.

We use a number of raw materials, including titanium, titanium alloys, stainless steel, PEEK, and human tissue. We rely from time to time on a number of suppliers and in one case on a single source vendor, Invibio. We have a supply agreement with Invibio, pursuant to which it supplies us with PEEK, a biocompatible plastic that we use in some of our spacers. Invibio is one of a limited number of companies approved to distribute PEEK in the U.S. for use in implantable devices. During 2013 and 2012 approximately 16% and 14%, respectively, of our revenues were derived from products manufactured using PEEK.

We depend on a limited number of sources of human tissue for use in our biologics products, and any failure to obtain tissue from these sources or to have the tissue processed by these entities for us in a timely manner will interfere with our ability to meet demand for our biologics products effectively. The processing of human tissue into biologics products is labor intensive and it is therefore difficult to maintain a steady supply stream. In addition, due to seasonal changes in mortality rates, some scarce tissues used for our biologics products are at times in particularly short supply. We cannot be certain that our supply of human tissue from our current suppliers and our current inventory of biologics products will be available at current levels or will be sufficient to meet our needs.

Our dependence on a single third-party PEEK supplier and the challenges we may face in obtaining adequate supplies of biologics products involve several risks, including limited control over pricing, availability, quality and delivery schedules. In addition, any supply interruption in a limited or sole sourced component or raw material, such as PEEK or human tissue, could materially harm our ability to manufacture our products until a new source of supply, if any, could be found. We may be unable to find a sufficient alternative supply channel in a reasonable time period or on commercially reasonable terms, if at all, which would have a significant adverse effect on our business, financial condition and results of operations.

Our tissue-based products and related technologies could become subject to significantly greater regulation by the FDA, which could disrupt our business.

The FDA may regulate certain tissue-based products as medical devices, drugs or biologics if the tissue in the product is deemed to have been more than minimally manipulated. If the FDA decides that any of our current or future products contain tissue that has been more than minimally manipulated, it would require us to either obtain 510(k) clearance or a PMA approval. Depending on the nature and extent of any FDA decision applicable to our tissue-based products, further distribution of the affected products could be interrupted for a substantial period of time, which would reduce our revenues and hurt our profitability.

Negative publicity concerning methods of tissue recovery and screening of donor tissue in our industry could reduce demand for biologics products and impact the supply of available donor tissue.

Media reports or other negative publicity concerning both alleged improper methods of tissue recovery from donors and disease transmission from donated tissue could limit widespread acceptance of biologics products. Unfavorable reports of improper or illegal tissue recovery practices, both in the U.S. and internationally, as well as incidents of improperly processed tissue leading to the transmission of disease, may broadly affect the rate of future tissue donation and market acceptance of biologics products. In addition, such negative publicity could cause the families of potential donors to become reluctant to agree to donate tissue to for-profit tissue processors, which could further limit the supply of tissue used in our biologics products, and thereby have a negative effect on our biologics products business.

If we or our suppliers fail to comply with the FDA's quality system and good tissue practice regulations, the manufacture of our products could be delayed.

We and our suppliers are required to comply with the FDA's QSRs, which cover the methods and documentation of the design, testing, production, control, quality assurance, labeling, packaging, sterilization, record keeping, storage and shipping of our products. In addition, suppliers and processors of products derived from human cells and tissues must comply with the FDA's current good tissue practice regulations, or CGTPs, which govern the methods used in and the facilities and controls used for the manufacture of human cell tissue and cellular products, record keeping and the establishment of a quality program. The FDA audits compliance with the QSRs and CGTPs through inspections of

manufacturing and other facilities. If we or our suppliers have significant non-compliance issues or if any corrective action plan is not sufficient, we or our suppliers could be forced to delay the manufacture of our products until such problems are corrected to the FDA's satisfaction, which could have a material adverse effect on our business, financial condition and results of operations. Further, our products could be subject to recall if the FDA determines, for any reason, that our products are not safe or effective. Any recall or FDA requirement demanding that we seek additional approvals or clearances could result in delays, costs associated with modification of a

product, loss of revenue and potential operating restrictions imposed by the FDA, all of which could have a material adverse effect on our business, financial condition and results of operations.

Healthcare policy changes, including recent federal legislation to reform the U.S. healthcare system, may have a material adverse effect on us.

In response to perceived increases in health care costs in recent years, there have been and continue to be proposals by the federal government, state governments, regulators and third-party payors to control these costs and, more generally, to reform the U.S. healthcare system. Certain of these proposals could limit the prices we are able to charge for our products or the amounts of reimbursement available for our products, limit the acceptance and availability of our products, and have a material adverse effect on our financial position and results of operations.

In March 2010, the U.S. Congress adopted and President Obama signed into law the ACA. The legislation imposes a 2.3% excise tax on domestic sales of medical devices which went into effect on January 1, 2013. These taxes are resulting in a significant increase in the tax burden on our industry. Other elements of this legislation include numerous provisions to limit Medicare spending through reductions in various fee schedule payments and by instituting more sweeping payment reforms, such as bundled payments for episodes of care, the establishment of “accountable care organizations” under which hospitals and physicians will be able to share savings that result from cost control efforts, comparative effectiveness research, value-based purchasing, and the establishment of an independent payment advisory board. Many of these provisions have been implemented through the regulatory process with most of the legislation implemented as of January 1, 2014. In addition, although ACA has been subject to various legal and legislative challenges, in June 2012 the United States Supreme Court upheld the constitutionality of the minimum essential health insurance coverage rule, or so-called personal mandate, while holding that the federal government must give states the option to accept ACA’s Medical expansion provisions without risk of losing all federal Medicaid funds. Pursuant to that ruling, several states have declined to expand Medicaid coverage. For those states, the failure to expand its Medicaid program as prescribed in ACA will restrict the ability of populations potentially served by such expansion to use our products. Other proposals have been introduced in Congress to repeal the device tax, and various healthcare reform proposals have also emerged at the state level. An expansion in government’s role in the U.S. healthcare industry may lower reimbursements for our products, reduce medical procedure volumes and adversely affect our business and results of operations, possibly materially.

The demand for our products and the prices at which customers and patients are willing to pay for our products depend upon the ability of our customers to obtain adequate third-party coverage and reimbursement for their purchases of our products.

Sales of our products depend in part on the availability of adequate coverage and reimbursement from governmental and private payors. In the U.S., healthcare providers that purchase our products generally rely on third-party payors, principally Medicare, Medicaid and private health insurance plans, to pay for all or a portion of the costs and fees associated with the use of our products. While our currently marketed products are eligible for reimbursement in the U.S., if surgical procedures utilizing our products are performed on an outpatient basis, it is possible that private payors may no longer provide reimbursement for our products without further supporting data on our procedure. Any delays in obtaining, or an inability to obtain, adequate coverage or reimbursement for procedures using our products could significantly affect the acceptance of our products and have a significant adverse effect on our business.

Additionally, third-party payors continue to review their coverage policies carefully for existing and new therapies and can, without notice, deny coverage for treatments that include the use of our products. Our business would be negatively impacted to the extent any such changes reduce reimbursement for our products.

With respect to coverage and reimbursement outside of the U.S., reimbursement systems in international markets vary significantly by country, and by region within some countries, and reimbursement approvals must be obtained on a country-by-country basis and can take up to 18 months, or longer. Many international markets have government-managed healthcare systems that govern reimbursement for new devices and procedures. In most markets, there are private insurance systems as well as government-managed systems. Additionally, some foreign reimbursement systems provide for limited payments in a given period and therefore result in extended payment periods. Reimbursement in international markets may require us to undertake country-specific reimbursement

activities, including additional clinical studies, which could be time consuming, expensive and may not yield acceptable reimbursement rates.

Furthermore, healthcare costs have risen significantly over the past decade. There have been and may continue to be proposals by legislators, regulators and third-party payors to contain these costs. Several such proposals were enacted as part of ACA, and include numerous provisions to limit Medicare spending through reductions in various fee schedule payments and sweeping payment reforms. Other federal and state cost-control measures include prospective payment systems, capitated rates, group purchasing, redesign of benefits, requiring pre-authorizations or second opinions prior to major surgery, encouragement

of healthier lifestyles and exploration of more cost-effective methods of delivering healthcare. Some healthcare providers in the U.S. have adopted or are considering a managed care system in which the providers contract to provide comprehensive healthcare for a fixed cost per person. Healthcare providers may also attempt to control costs by authorizing fewer elective surgical procedures or by requiring the use of the least expensive devices possible. These cost-control methods also potentially limit the amount which healthcare providers may be willing to pay for medical devices. In addition, in the U.S., no uniform policy of coverage and reimbursement for medical technology exists among all these payors. Therefore, coverage of and reimbursement for medical technology can differ significantly from payor to payor. The continuing efforts of third-party payors, whether governmental or commercial, whether inside the U.S. or outside, to contain or reduce these costs, combined with closer scrutiny of such costs, could restrict our customers' ability to obtain adequate coverage and reimbursement from these third-party payors. The cost containment measures contained in ACA and other measures being considered at the federal and state level, as well as internationally, could harm our business by adversely affecting the demand for our products or the price at which we can sell our products.

Consolidation in the healthcare industry could lead to demands for price concessions or to the exclusion of some suppliers from certain of our markets, which could have an adverse effect on our business, financial condition or results of operations.

Because healthcare costs have risen significantly over the past decade, numerous initiatives and reforms initiated by legislators, regulators and third-party payors to curb these costs have resulted in a consolidation trend in the healthcare industry to create new companies with greater market power, including hospitals. As the healthcare industry consolidates, competition to provide products and services to industry participants has become and will continue to become more intense. This in turn has resulted and will likely continue to result in greater pricing pressures and the exclusion of certain suppliers from important market segments as group purchasing organizations, independent delivery networks and large single accounts continue to use their market power to consolidate purchasing decisions for some of our customers. We expect that market demand, government regulation, third-party reimbursement policies and societal pressures will continue to change the worldwide healthcare industry, resulting in further business consolidations and alliances among our customers, which may reduce competition, exert further downward pressure on the prices of our products and may adversely impact our business, financial condition or results of operations. We may be subject to or otherwise affected by federal and state healthcare laws, including fraud and abuse, health information privacy and security, and disclosure laws, and could face substantial penalties if we are unable to fully comply with such laws.

Although we do not provide healthcare services, submit claims for third-party reimbursement, or receive payments directly from Medicare, Medicaid, or other third-party payors for our products or the procedures in which our products are used, healthcare regulation by federal and state governments significantly impacts our business. Healthcare fraud and abuse, health information privacy and security, and disclosure laws potentially applicable to our operations include:

- the federal Anti-Kickback Statute, as well as state analogs, which constrains our marketing practices and those of our independent sales agents and distributors, educational programs, pricing policies, and relationships with healthcare providers by prohibiting, among other things, knowingly and willfully soliciting, receiving, offering or providing remuneration, intended to induce the purchase or recommendation of an item or service reimbursable under a federal (or state or commercial) healthcare program (such as the Medicare or Medicaid programs);

- the federal ban, as well as state analogs, on physician self-referrals, which prohibits, subject to certain exceptions, physician referrals of Medicare and Medicaid patients to an entity providing certain "designated health services" if the physician or an immediate family member of the physician has any financial relationship with the entity;

- federal false claims laws which prohibit, among other things, knowingly presenting, or causing to be presented, claims for payment from Medicare, Medicaid, or other third-party payors that are false or fraudulent;

- HIPAA, and its implementing regulations, which created federal criminal laws that prohibit executing a scheme to defraud any healthcare benefit program or making false statements relating to healthcare matters;

-

the state and federal laws “sunshine” provisions that require detailed reporting and disclosures to CMS and applicable states of any payments or “transfer of value” made or distributed to prescribers and other health care providers, and for certain states prohibit some forms of these payments, require the adoption of marketing codes of conduct, and constrain their relationships with physicians and other referral sources;

state laws analogous to each of the above federal laws, such as anti-kickback and false claims laws that may apply to items or services reimbursed by any third-party payor, including commercial insurers, and state laws governing the

privacy of certain health information, many of which differ from each other in significant ways and often are not preempted by HIPAA, thus complicating compliance efforts; the Administrative Simplification provisions of HIPAA, specifically, privacy and security provisions including recent amendments under HITECH which impose stringent restrictions on uses and disclosures of protected health information such as for marketing or clinical research purposes and impose significant civil and criminal penalties for non-compliance and require the reporting of breaches to affected individuals, the government and in some cases the media in the event of a violation; and a variety of state-imposed privacy and data security laws which require the protection of information beyond health information, such as employee information or any class of information combining name with state issued identification numbers, social security numbers, credit card, bank or other financial information and which require reporting to state officials in the event of breach or violation and which impose both civil and criminal penalties. ACA includes various provisions designed to strengthen significantly fraud and abuse enforcement, such as increased funding for enforcement efforts and the lowering of the intent requirement of the federal Anti-Kickback Statute and criminal healthcare fraud statute such that a person or entity no longer needs to have actual knowledge of these statutes or specific intent to violate them.

If our past or present operations, or those of our independent sales agents and distributors are found to be in violation of any of such laws or any other governmental regulations that may apply to us, we may be subject to penalties, including civil and criminal penalties, damages, fines, exclusion from federal healthcare programs and/or the curtailment or restructuring of our operations. Similarly, if the healthcare providers, sales agents, distributors or other entities with which we do business are found to be non-compliant with applicable laws, they may be subject to sanctions, which could also have a negative impact on us. Any penalties, damages, fines, curtailment or restructuring of our operations could adversely affect our ability to operate our business and our financial results. The risk of our being found in violation of these laws is increased by the fact that many of them have not been fully interpreted by the regulatory authorities or the Courts, and their provisions are open to a variety of interpretations. Any action against us for violation of these laws, even if we successfully defend against them, could cause us to incur significant legal expenses and divert our management's attention from the operation of our business.

In January 2004, the Advanced Medical Technology Association, or AdvaMed, the principal U.S. trade association for the medical device industry, put in place a model "code of conduct", or the AdvaMed Code, that sets forth standards by which its members should abide in the promotion of their products. Although we are not a member of AdvaMed, we have in place policies and procedures for compliance that we believe are at least as stringent as those set forth in the AdvaMed Code, and we provide routine training to our sales and marketing personnel on our policies regarding sales and marketing practices.

The sales and marketing practices of our industry have been the subject of increased scrutiny from federal and state government agencies, and we believe that this trend will continue. For example, on March 26, 2013 the OIG issued a Special Fraud Alert entitled "Physician-Owned Entities" related to physician-owned distributors, or PODS. We believe that all of our arrangements with PODs comply with applicable fraud and abuse laws and do not believe that we are subject to any arrangements that violate any such laws. Prosecutorial scrutiny and governmental oversight over some major device companies regarding the retention of healthcare professionals as consultants has affected and may continue to affect the manner in which medical device companies may retain healthcare professionals as consultants. We have in place policies to govern how we may retain healthcare professionals as consultants that reflect the current climate on this issue and are providing training on these policies. Any action against us for violation of these laws, even if we successfully defend against them, could cause us to incur significant legal expenses and divert our management's attention from the operation of our business.

Our international operations may expose us to liabilities under the Foreign Corrupt Practices Act and Money Laundering Laws.

We may be exposed to liabilities under the U.S. Foreign Corrupt Practices Act, or FCPA, which generally prohibits companies and their intermediaries from making corrupt payments to foreign officials for the purpose of obtaining or keeping business or otherwise obtaining favorable treatment, and requires companies to maintain adequate record keeping and internal accounting practices to accurately reflect the transactions of the company. We are also subject to

a number of other laws and regulations relating to money laundering, international money transfers and electronic fund transfers, which we collectively refer to as Money Laundering Laws. These laws apply to companies, individual directors, officers, employees and agents.

We operate in a number of jurisdictions with developing economies that pose a high risk of potential violations of the FCPA and Money Laundering Laws, and we utilize third-party distributorships that have government customers. If our employees, third-party distributors or other agents are found to have engaged in such practices, we could suffer severe penalties, including criminal and civil penalties, disgorgement and other remedial measures, any of which could have a material adverse effect on our business, financial condition and results of operations.



If we fail to obtain, or experience significant delays in obtaining, FDA clearances or approvals for our future products or modifications to our products, our ability to commercially distribute and market our products could suffer. Our medical devices are subject to extensive regulation by the FDA and numerous other federal, state and foreign governmental authorities. The process of obtaining regulatory clearances or approvals to market a medical device, particularly from the FDA, can be costly and time consuming, and there can be no assurance that such clearances or approvals will be granted on a timely basis, if at all. In particular, the FDA permits commercial distribution of most new medical devices only after the devices have received clearance under Section 510(k) of the Federal Food, Drug and Cosmetic Act, or 510(k), or are the subject of an approved premarket approval application, or a PMA. The 510(k) process generally takes three to nine months, but can take significantly longer, especially if the FDA requires a clinical study to support the 510(k) application. Currently, we are not certain as to whether the FDA will require clinical data in support of any 510(k)s that we intend to submit for other products in our pipeline. In addition, the FDA is currently re-examining its 510(k) clearance process for medical devices and recently published several draft guidance documents that could change that process. Any changes that make the process more restrictive could increase the time it takes for us to obtain clearances or could make the 510(k) process unavailable for certain of our products. A PMA must be submitted to the FDA if the device cannot be cleared through the 510(k) process or is not exempt from premarket review by the FDA. A PMA must be supported by extensive data, including results of preclinical studies and clinical trials, manufacturing and control data and proposed labeling, to demonstrate to the FDA's satisfaction the safety and effectiveness of the device for its intended use. The PMA process is more costly and uncertain than the 510(k) clearance process, and generally takes between one and three years, if not longer. In addition, any modification to a 510(k)-cleared device that could significantly affect its safety or effectiveness, or that would constitute a major change in its intended use, design or manufacture, requires a new 510(k) clearance or, possibly, a PMA.

Our commercial distribution and marketing of any products or product modifications that we develop may be delayed since regulatory clearance or approval is required. In addition, because we cannot assure you that any new products or any product modifications we develop will be subject to the shorter 510(k) clearance process, the regulatory approval process for our new products or product modifications may take significantly longer than anticipated. There is no assurance that the FDA will not require a new product or product modification to go through the lengthy and expensive PMA approval process. Delays in obtaining regulatory clearances and approvals may:

- delay or prevent commercialization of products we develop;
- require us to perform costly procedures;
- diminish any competitive advantages that we might otherwise have obtained;
- and
- reduce our ability to collect revenues.

To date, all of our non-biologic medical device products that have required FDA review that are being sold in the U.S. have been cleared through the 510(k) process without any required clinical trials. However, the FDA may require clinical data in support of any 510(k)s that we intend to submit for products in our pipeline. We have limited experience in obtaining approval for a device through the 510(k) clinical trial process or the PMA process. If any of our products require the 510(k) clinical process or the PMA process, such processes could delay the commercialization of such products and could have a material adverse effect on our business, financial condition and results of operations.

The safety of our products is not yet supported by long-term clinical data and may therefore prove to be less safe and effective than initially thought.

We obtained clearance to offer all of our current non-biologic medical device products through the FDA's 510(k) clearance process. The 510(k) clearance process is generally based on the FDA's agreement that a new product is substantially equivalent to already marketed products. Because most 510(k) cleared products were not the subject of pre-clearance clinical trials, surgeons may be slow to adopt our 510(k)-cleared products, we may not have the comparative data that our competitors have or are generating, and we may be subject to greater regulatory and product liability risks. With the passage of the American Recovery and Reinvestment Act of 2009, funds have been appropriated for the U.S. Department of Health and Human Services' Healthcare Research and Quality to conduct

comparative effectiveness research to determine the effectiveness of different drugs, medical devices, and procedures in treating certain conditions and diseases. Some of our products or procedures performed with our products could become the subject of such research. It is unknown what effect, if any, this research may have on our business. Further, future research or experience may indicate that treatment with our products does not improve patient outcomes or improves patient outcomes less than we initially expect. Such results would reduce demand for our products and this could cause us to withdraw our products from the market. Moreover, if future research or experience indicate that our products cause unexpected or serious complications or other unforeseen negative effects, we could be subject to significant legal liability, significant negative publicity, damage to our reputation and a dramatic reduction in sales of our products, all of which would have a material adverse effect on our business, financial condition and results of operations.

If clinical trials of our current or future product candidates do not produce results necessary to support regulatory approval in the U.S., we will be unable to commercialize these products.

Several investigational devices in our development pipeline, including our OsseoScrew System require either a 510(k) with clinical trial data or a PMA from the FDA before we can market such product in the U.S. The clinical trial is required by the FDA to demonstrate to the FDA's satisfaction the safety and effectiveness of the device for its intended use. As a result, to receive regulatory approval in the U.S. OsseoScrew, we must conduct, at our own expense, a clinical trial to demonstrate efficacy and safety in humans. Clinical testing is expensive and has an uncertain outcome. Clinical failure can occur at any stage of the testing. Our clinical trials may produce negative or inconclusive results, and we may decide, or regulators may require us, to conduct additional clinical and/or non-clinical testing. Our failure to adequately demonstrate the efficacy and safety of any of our devices would prevent receipt of regulatory approval and, ultimately, the commercialization of that device.

If we choose to acquire new and complementary businesses, products or technologies, we may be unable to complete these acquisitions or successfully integrate them in a cost-effective and non-disruptive manner.

Our success depends in part on our ability to continually enhance and broaden our product offering in response to changing customer demands, competitive pressures and technologies and our ability to increase our market share.

Accordingly, we have pursued and intend to pursue the acquisition of complementary businesses, products or technologies instead of developing them ourselves. We do not know if we will be able to successfully complete any acquisitions, or whether we will be able to successfully integrate any acquired business, product or technology into our business or retain any key personnel, suppliers or distributors. Our ability to successfully grow through acquisitions depends upon our ability to identify, negotiate, complete and integrate suitable acquisitions and to obtain any necessary financing. These efforts could be expensive and time consuming, disrupt our ongoing business and distract management. If we are unable to integrate any future or recently acquired businesses, products or technologies effectively, our business, financial condition and results of operations will be materially adversely affected. For example, an acquisition could materially impair our operating results by causing us to incur debt or requiring us to amortize significant amounts of expenses, including non-cash acquisition costs, and acquired assets.

We may not be able to timely develop new products or product enhancements that will be accepted by the market.

We sell our products in a market that is characterized by technological change, product innovation, evolving industry standards, competing patent claims, patent litigation and intense competition. Our success will depend in part on our ability to develop and introduce new products and enhancements or modifications to our existing products, which we will need to do before our competitors do so and in a manner that does not infringe issued patents of third parties from which we do not have a license. We cannot assure you that we will be able to successfully develop or market new, improved or modified products, or that any of our future products will be accepted by even the surgeons who use our current products. Our competitors' product development capabilities could be more effective than our capabilities, and their new products may get to market before our products. In addition, the products of our competitors may be more effective or less expensive than our products. The introduction of new products by our competitors may lead us to have price reductions, reduced margins or loss of market share and may render our products obsolete or noncompetitive. The success of any of our new product offerings or enhancement or modification to our existing products will depend on several factors, including our ability to:

- properly identify and anticipate surgeon and patient needs;
- develop new products or enhancements in a timely manner;
- obtain the necessary regulatory approvals for new products or product enhancements;
- provide adequate training to potential users of new products;
- receive adequate reimbursement approval of third-party payors such as Medicaid, Medicare and private insurers; and
- develop an effective marketing and distribution network.

Developing products in a timely manner can be difficult, in particular because product designs change rapidly to adjust to third-party patent constraints and to market preferences. As a result, we may experience delays in our product launches which may significantly impede our ability to enter or compete in a given market and may reduce the sales that we are able to generate from these products. We may experience delays in any phase of a product launch, including during research and development, clinical trials, manufacturing, marketing and the surgeon training process.

In addition, our suppliers of products or components that we do not manufacture can suffer similar delays, which could cause delays in our product introductions. If we do not develop new products or product enhancements in time to meet market demand or if there is insufficient demand for these new products or enhancements, it could have a significant adverse effect on our business financial condition and results of operations.

We are dependent on our senior management team, sales and marketing team, engineering team and key surgeon advisors, and the loss of any of them could harm our business.

Our continued success depends in part upon the continued availability and contributions of our senior management, sales and marketing team and engineering team and the continued participation of our key surgeon advisors. While we have entered into employment agreements with all members of our senior management team, other than with respect to our President of Alphatec Pacific, none of these agreements guarantees the services of the individual for a specified period of time. We would be adversely affected if we fail to adequately prepare for future turnover of our senior management team. Our ability to grow or at least maintain our sales levels depends in large part on our ability to attract and retain sales and marketing personnel and for these sales people to maintain their relationships with surgeons directly and through our distributors. We rely on our engineering team to research, design and develop potential products for our product pipeline. We also rely on our surgeon advisors to advise us on our products, our product pipeline, long-term scientific planning, research and development and industry trends. We compete for personnel and advisors with other companies and other organizations, many of which are larger and have greater name recognition and financial and other resources than we do. The loss of members of our senior management team, sales and marketing team, engineering team and key surgeon advisors, or our inability to attract or retain other qualified personnel or advisors, could have a significant adverse effect on our business, financial conditions and results of operations.

We rely on our information technology systems for inventory management, distribution and other functions and to maintain our research and development data. If our information technology systems fail to adequately perform these functions, or if we experience an interruption in their operation, our business, financial condition and results of operations could be adversely affected.

The efficient operation of our business is dependent on our information technology systems. We rely on our information technology systems to effectively manage accounting and financial functions; manage order entry, order fulfillment and inventory replenishment processes; and maintain our research and development data. The failure of our information technology systems to perform as we anticipate could disrupt our business and product development and could result in decreased sales, increased overhead costs, excess inventory and product shortages, all of which could have a significant adverse effect on our business, financial condition and results of operations. In addition, our information technology systems are vulnerable to damage or interruption from:

- earthquake, fire, flood and other natural disasters;
- terrorist attacks and attacks by computer viruses or hackers;
- power loss; and
- computer systems, or Internet, telecommunications or data network failure.

Any such interruption could have significant adverse effect on our business, financial condition and results of operations.

The majority of our operations and all of our manufacturing facilities are currently conducted in locations that may be at risk of damage from fire, earthquakes or other natural disasters. If a natural disaster strikes, we may be unable to manufacture certain products for a substantial amount of time.

We currently conduct the majority of our development, manufacturing and management activities in Carlsbad, California near known wildfire areas and earthquake fault zones. We have taken precautions to safeguard our facilities, including obtaining property and casualty insurance, and implementing health and safety protocols. We have developed an information technology disaster recovery plan. However, any future natural disaster, such as a fire or an earthquake, could cause substantial delays in our operations, damage or destroy our equipment or inventory and cause us to incur additional expenses. A disaster could seriously harm our business, financial condition and results of operations. Our facilities would be difficult to replace and would require substantial lead time to repair or replace. The insurance we maintain against earthquakes, fires, and other natural disasters would not be adequate to cover a total loss of our manufacturing facilities, may not be adequate to cover our losses in any particular case and may not continue to be available to us on acceptable terms, or at all.



Alphatec Holdings is a holding company with no operations, and unless it receives dividends or other payments from its subsidiaries, it will be unable to fulfill its cash obligations.

As a holding company with no business operations, Alphatec Holdings' material assets consist only of the common stock of its subsidiaries, including Alphatec Spine and Scient'x, dividends and other payments received from time to time from its subsidiaries, and the proceeds raised from the sale of debt and equity securities. Alphatec Holdings' subsidiaries are legally distinct from Alphatec Holdings and have no obligation, contingent or otherwise, to make funds available to Alphatec Holdings. Alphatec Holdings will have to rely upon dividends and other payments from its subsidiaries to generate the funds necessary to fulfill its cash obligations. Alphatec Holdings may not be able to access cash generated by its subsidiaries in order to fulfill cash commitments. The ability of Alphatec Spine to make dividend and other payments to Alphatec Holdings is subject to the availability of funds after taking into account its subsidiaries' funding requirements, the terms of its subsidiaries' indebtedness and applicable state laws.

Compliance with changing regulations and standards for accounting, corporate governance and public disclosure may result in additional expenses.

Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new SEC regulations, including accelerated SEC filing timelines and new Proxy rules, new NASDAQ Stock Market rules, and new accounting pronouncements are creating uncertainty and additional complexities for companies such as ours. In particular, the Section 404 internal control evaluation requirements under the Sarbanes-Oxley Act have added and will continue to add complexity and costs to our business and require a significant investment of our time and resources to complete each year. We take these requirements seriously and will make every effort to ensure that we receive clean attestations on our internal controls each year from our outside auditors, but there is no guarantee that our efforts to do so will be successful. To maintain high standards of corporate governance and public disclosure, we intend to invest all reasonably necessary resources to comply with all other evolving standards. These investments may result in increased general and administrative expenses and a diversion of management time and attention from strategic revenue generating and cost management activities.

If we fail to maintain effective internal controls and procedures for financial reporting, we could be unable to provide timely and accurate financial information and therefore be subject to delisting from The NASDAQ Global Select Market, an investigation by the SEC, and civil or criminal sanctions. Additionally, ineffective internal control over financial reporting would place us at increased risk of fraud or misuse of corporate assets and could cause our stockholders, lenders, suppliers and others to lose confidence in the accuracy or completeness of our financial reports.

#### Risks Related to Our Financial Results and Need for Financing

Our quarterly financial results could fluctuate significantly.

Our quarterly financial results are difficult to predict and may fluctuate significantly from period to period, particularly because our sales prospects are uncertain. The level of our revenues and results of operations at any given time will be based primarily on the following factors:

- acceptance of our products by surgeons, patients, hospitals and third-party payors;
- demand and pricing of our products;
- the mix of our products sold, because profit margins differ among our products;
- timing of new product offerings, acquisitions, licenses or other significant events by us or our competitors;
- our ability to grow and maintain a productive sales and marketing organization;
- regulatory approvals and legislative changes affecting the products we may offer or those of our competitors;
- the effect of competing technological and market developments;
- levels of third-party reimbursement for our products;
- interruption in the manufacturing or distribution of our products;
- our ability to produce or obtain products of satisfactory quality or in sufficient quantities to meet demand; and
- changes in our ability to obtain FDA, state and international approval or clearance for our products.

In addition, until we have a larger base of surgeons using our products, occasional fluctuations in the use of our products by individual surgeons or small groups of surgeons will have a proportionately larger impact on our revenues than for companies with a larger customer base.

Many of the products we may seek to develop and introduce in the future will require FDA, state and international approval or clearance. We cannot begin to commercialize any such products in the U.S. without FDA approval or clearance or outside of the U.S. without appropriate regulatory approvals and import licenses. As a result, it will be difficult for us to forecast demand for these products with any degree of certainty. We cannot assure you that our revenue will increase or be sustained in future periods or that we will be profitable in any future period. Any shortfalls in revenue or earnings from levels expected by our stockholders or by securities or industry analysts could have an immediate and significant adverse effect on the trading price of our common stock in any given period.

We may need to raise additional funds in the future and such funds may not be available on acceptable terms, if at all. We believe that our current cash, revenues from our operations, and Alphatec Spine's ability to draw down on its credit facilities, will be sufficient to fund our projected operating requirements through December 31, 2014. Despite this belief, we may seek additional funds from public and private stock offerings, borrowings under new debt facilities or other sources. Our capital requirements will depend on many factors, including:

- the payments due in connection with the settlement of the Cross Medical and Orthotec matters;
- the costs associated with the restructuring of our French operations;
- the revenues generated by sales of our products;
- the costs associated with expanding our sales and marketing efforts;
- the expenses we incur in manufacturing and selling our products;
- the costs of developing new products or technologies;
- the cost of obtaining and maintaining FDA or other regulatory approval or clearance for our products and products in development;
- the number and timing of acquisitions and other strategic transactions;
- the costs and any payments we may make, related to our pending litigation matters (in addition to the Orthotec matter);
- the costs associated with increased capital expenditures; and
- the costs associated with our employee retention programs and related benefits.

As a result of these factors, we may need to raise additional funds and such funds may not be available on favorable terms, if at all. Furthermore, if we issue equity or debt securities to raise additional funds, our existing stockholders may experience dilution and the new equity or debt securities may have rights, preferences and privileges senior to those of our existing stockholders. In addition, if we raise additional funds through collaboration, licensing or other similar arrangements, it may be necessary to relinquish valuable rights to our potential products or proprietary technologies, or to grant licenses on terms that are not favorable to us. If we cannot raise funds on acceptable terms, we may not be able to develop or enhance our products, execute our business plan, take advantage of future opportunities, or respond to competitive pressures or unanticipated customer requirements. Any of these events could adversely affect our ability to achieve our development and commercialization goals and have a significant adverse effect on our business, financial condition and results of operations.

We may be unable to comply with the covenants of our credit facility.

We must comply with certain affirmative and negative covenants, including financial covenants, in our credit facility with MidCap Financial, LLC, or the Credit Facility. In order to comply with the financial covenants for 2014, we will need to achieve revenue and earnings that meet or exceed our historical revenue and earnings levels. If we are not able to achieve planned revenue or earnings growth or if we incur costs in excess of our forecast, we may be required to substantially reduce discretionary spending and could be in default of the Credit Facility. In addition to financial covenants, the Credit Facility also contains customary affirmative and negative covenants for loan agreements of this type, including, but not limited to, limitations on the incurrence of indebtedness, asset dispositions, acquisitions, investments, dividends and other restricted payments, liens and transactions with affiliates, the breach of which could result in an event of default. There can be no assurance that at all times in the future we will satisfy all such financial or other covenants or obtain any required waiver or amendment, in which event of default the lenders party to the



Credit Facility could refuse to make further extensions of credit to us and require all amounts borrowed under the Credit Facility, together with accrued interest and other fees, to be immediately due and payable. In addition to allowing the lenders to accelerate the loan, several events of default under the

Credit Facility, such as our failure to make required payments of principal and interest and the occurrence of certain bankruptcy or insolvency events, could require us to pay interest at a rate which is up to five percentage points higher than the interest rate effective immediately before the event of default.

An event of default under the Credit Facility could have a material adverse effect on us. Upon an event of default, if the lenders under the Credit Facility accelerate the repayment of all amounts borrowed, together with accrued interest and other fees, or if the lenders elect to charge us additional interest, we cannot assure you that we will have sufficient cash available to repay the amounts due, and we may be forced to seek to amend the terms of the Credit Facility or obtain alternative financing, which may not be available to us on acceptable terms, if at all.

In addition, if we fail to pay amounts when due under the Credit Facility or upon the occurrence of another event of default, the lenders under the Credit Facility could proceed against the collateral granted to them pursuant to the Credit Facility. We have granted to the lenders a first priority security interest in substantially all of our assets, including all accounts receivable and all securities evidencing our interests in our subsidiaries, as collateral under the Credit Facility. If the lenders proceed against the collateral, such assets would no longer be available for use in our business, which would have a significant adverse effect on our business, financial condition and results of operations. If we default on our obligations to make settlement payments to Cross Medical Products, the amounts due under the settlement agreements accelerate and become due and payable.

Any default of our payment obligation under the settlement agreements we entered into with Cross Medical Products, or Cross, would give Cross the right to declare all of the future payments to be immediately payable, together with additional payments to cover interest and Cross' legal fees. As of March 19, 2014, the outstanding amount to be paid to Cross Medical through August 2015 is \$6,000,000. If this acceleration of payments occurs, our business, financial condition and results of operations could be materially and adversely affected.

#### Risks Related to Our Intellectual Property Regulatory Penalties and Potential Litigation

If our patents and other intellectual property rights do not adequately protect our products, we may lose market share to our competitors and be unable to operate our business profitably.

Our success depends significantly on our ability to protect our proprietary rights of the technologies used in our products. We rely on patent protection, as well as a combination of copyright, trade secret and trademark laws, and nondisclosure, confidentiality and other contractual restrictions to protect our proprietary technology. However, these legal means afford only limited protection and may not adequately protect our rights or permit us to gain or keep any competitive advantage. For example, we cannot assure you that any of our pending patent applications will result in the issuance of patents to us. The U.S. Patent and Trademark Office, or PTO, may deny or require significant narrowing of claims in our pending patent applications, and patents issued as a result of the pending patent applications, if any, may not provide us with significant commercial protection or be issued in a form that is advantageous to us. We could also incur substantial costs in proceedings before the PTO. These proceedings could result in adverse decisions as to the priority of our inventions and the narrowing or invalidation of claims in issued patents. Our issued patents and those that may be issued in the future could subsequently be successfully challenged by others and invalidated or rendered unenforceable, which could limit our ability to stop competitors from marketing and selling related products. In addition, our pending patent applications include claims to aspects of our products and procedures that are not currently protected by issued patents.

Both the patent application process and the process of managing patent disputes can be time consuming and expensive. Competitors may be able to design around our patents or develop products that provide outcomes that are comparable to our products but fall outside of the scope of our patent protection. Although we have entered into confidentiality agreements and intellectual property assignment agreements with certain of our employees, consultants and advisors as one of the ways we seek to protect our intellectual property and other proprietary technology, such agreements may not be enforceable or may not provide meaningful protection for our trade secrets or other proprietary information in the event of unauthorized use or disclosure or other breaches of the agreements. Furthermore, the laws of some foreign countries may not protect our intellectual property rights to the same extent as the laws of the U.S., if at all. Since most of our issued patents and pending patent applications are for the U.S. only, we lack a corresponding scope of patent protection in other countries, including Japan. Thus, we may not be able to stop a competitor from marketing products in other countries that are similar to some of our products.

In the event a competitor infringes upon one of our patents or other intellectual property rights, enforcing those patents and rights may be difficult and time consuming. Even if successful, litigation to defend our patents against challenges or to enforce our intellectual property rights could be expensive and time consuming and could divert management's attention from managing our business. Moreover, we may not have sufficient resources to defend our patents against challenges or to enforce our intellectual property rights.

The medical device industry is characterized by patent and other intellectual property litigation and we could become subject to litigation that could be costly, result in the diversion of management's time and efforts, require us to pay damages, and/or prevent us from marketing our existing or future products.

The medical device industry is characterized by extensive litigation and administrative proceedings over patent and other intellectual property rights. Determining whether a product infringes a patent involves complex legal and factual issues, the determination of which is often uncertain. Our competitors may assert that our products, the components of those products, the methods of using those products, or the methods we employ in manufacturing or processing those products are covered by U.S. or foreign patents held by them. In addition, they may claim that their patents have priority over ours because their patents were filed first. Because patent applications can take many years to issue, there may be applications now pending of which we are unaware, which may later result in issued patents that our products may infringe. There could also be existing patents that one or more components of our products may be inadvertently infringing, of which we are unaware. As the number of participants in the market for spine disorder devices and treatments increases, the possibility of patent infringement claims against us also increases.

Any such claim against us, even those without merit, may cause us to incur substantial costs, and could place a significant strain on our financial resources, divert the attention of management from our core business and harm our reputation. If the relevant patents are upheld as valid and enforceable and we are found to infringe, we could be required to pay substantial damages, including treble, or triple, damages if an infringement is found to be willful, and/or royalties and we could be prevented from selling our products unless we could obtain a license or were able to redesign our products to avoid infringement. Any such license may not be available on reasonable terms, if at all, and there can be no assurance that we would be able to redesign our products in a way that would not infringe those patents, and any such redesign, if possible, may be costly. If we fail to obtain any required licenses or make any necessary changes to our products or technologies, we may have to withdraw existing products from the market or may be unable to commercialize one or more of our products, either of which could have a significant adverse effect on our business, financial condition and results of operations.

In addition, in order to further our product development efforts, from time to time we enter into agreements with surgeons to develop new products. As consideration for product development activities rendered pursuant to these agreements, in certain instances we have agreed to pay such surgeons royalties on products developed by cooperative involvement between us and such surgeons. There can be no assurance that surgeons with whom we have entered into such an arrangement will not claim to be entitled to a royalty even if we do not believe that such products were developed by cooperative involvement between us and such surgeons. Any such claim against us, even those without merit, may cause us to incur substantial costs, and could place a significant strain on our financial resources, divert the attention of management from our core business and harm our reputation.

If we become subject to product liability claims, we may be required to pay damages that exceed our insurance coverage.

Our business exposes us to potential product liability claims that are inherent in the testing, design, manufacture and sale of medical devices for spine surgery procedures. Spine surgery involves significant risk of serious complications, including bleeding, nerve injury, paralysis and even death. To date, our products have not been the subject of any material product liability claims. Currently, we carry product liability insurance in the amount of \$20 million per occurrence and \$20 million in the aggregate. Our existing product liability insurance coverage may be inadequate to satisfy liabilities we might incur. Any product liability claim brought against us, with or without merit, could result in the increase of our product liability insurance rates or our inability to secure coverage in the future on commercially reasonable terms, if at all. In addition, if our product liability insurance proves to be inadequate to pay a damage award, we may have to pay the excess out of our cash reserves, which could harm our financial condition. If longer-term patient results and experience indicate that our products or any component of our products cause tissue damage, motor impairment or other adverse effects, we could be subject to significant liability. Even a meritless or unsuccessful product liability claim could harm our reputation in the industry, lead to significant legal fees and result in the diversion of management's attention from managing our business. If a product liability claim or series of claims is brought against us in excess of our insurance coverage limits, our business could suffer and our financial condition, results of operations and cash flow could be materially adversely impacted.

Because biologics products entail a potential risk of communicable disease to human recipients, we may be the subject of product liability claims regarding our biologics products.

Our biologics products may expose us to additional potential product liability claims. The development of biologics products entails a risk of additional product liability claims because of the risk of transmitting disease to human recipients, and substantial product liability claims may be asserted against us. In addition, successful product liability claims made against one of our competitors could cause claims to be made against us or expose us to a perception that we are vulnerable to similar claims. Even a meritless or unsuccessful product liability claim could harm our reputation in the industry, lead to significant legal fees and result in the diversion of management's attention from managing our business.

Any claims relating to our improper handling, storage or disposal of biological, hazardous and radioactive materials could be time consuming and costly.

The manufacture of certain of our products, including our biologics products, involves the controlled use of biological, hazardous and/or radioactive materials and waste. Our business and facilities and those of our suppliers are subject to foreign, federal, state and local laws and regulations governing the use, manufacture, storage, handling and disposal of these hazardous materials and waste products. Although we believe that our safety procedures for handling and disposing of these materials comply with legally prescribed standards, we cannot completely eliminate the risk of accidental contamination or injury from these materials. In the event of an accident, we could be held liable for damages or penalized with fines. This liability could exceed our resources and any applicable insurance. In addition, under some environmental laws and regulations, we could also be held responsible for all of the costs relating to any contamination at our past or present facilities and at third-party waste disposal sites, even if such contamination was not caused by us. We may incur significant expenses in the future relating to any failure to comply with environmental laws. Any such future expenses or liability could have a significant negative impact on our business, financial condition and results of operations.

We may be subject to damages resulting from claims that we, our employees or our independent distributors have wrongfully used or disclosed alleged trade secrets of our competitors or are in breach of non-competition or non-solicitation agreements with our competitors.

Many of our employees were previously employed at other medical device companies, including our competitors or potential competitors. Many of our independent distributors sell, or in the past have sold, products of our competitors. We may be subject to claims that we, our employees or our independent distributors have inadvertently or otherwise used or disclosed the trade secrets or other proprietary information of our competitors. In addition, we have been and may in the future be subject to claims that we caused an employee or independent distributor to break the terms of his or her non-competition agreement or non-solicitation agreement. Litigation may be necessary to defend against such claims. Even if we are successful in defending against such claims, litigation could result in substantial costs and be a distraction to management. If we fail in defending such claims, in addition to paying monetary damages, we may lose valuable intellectual property rights and/or personnel. A loss of key personnel and/or their work product could hamper or prevent our ability to commercialize products, which could have an adverse effect on our business, financial condition and results of operations.

We, certain of our directors and officers and HealthpointCapital have been named as a defendant in two related litigation matters, the result of which is uncertain.

On August 10, 2010, a purported securities class action complaint was filed in the United States District Court for the Southern District of California on behalf of all persons who purchased our common stock between December 19, 2009 and August 5, 2010 against us and certain of our directors and officers alleging violations of the Securities Exchange Act of 1934, as amended, and Rule 10b-5 promulgated thereunder. On February 17, 2011, an amended complaint was filed against us and certain of its directors and officers adding alleged violations of the Securities Act of 1933, as amended. HealthpointCapital, Jefferies & Company, Inc., Canaccord Adams, Inc., Cowen and Company, Inc., and Lazard Capital Markets LLC are also defendants in this action. The complaint alleges that the defendants made false or misleading statements, as well as failed to disclose material facts, about the Company's business, financial condition, operations and prospects, particularly relating to the Scient'x transaction and our financial guidance following the closing of the acquisition. The complaint seeks unspecified monetary damages, attorneys' fees, and other unspecified relief. We believe that the claims are without merit and we intend to vigorously defend ourselves against this complaint. However, the outcome of the litigation cannot be predicted at this time and any outcome that is adverse to us, regardless of who the defendant is, could have a significant adverse effect on our financial condition and results of operations. For a more detailed description of this matter, please see "Item 3 Legal Proceedings".

On August 25, 2010, an alleged shareholder of the Company's filed a derivative lawsuit in the Superior Court of California, San Diego County, purporting to assert claims on behalf of the Company against all of its directors and certain of its officers and HealthpointCapital. Following the filing of this complaint, similar complaints were filed in the same court and in the U.S. District Court for the Southern District of California against the same defendants

containing similar allegations. The complaint filed in federal court was dismissed by the plaintiff without prejudice in July 2011. The state court complaints have been consolidated into a single action and the Company has been named as a nominal defendant in the consolidated action. Each complaint alleges that the Company's directors and certain of its officers breached their fiduciary duties to the Company related to the Scient'x transaction, and by making allegedly false statements that led to unjust enrichment of HealthpointCapital and certain of the Company's directors. The complaints seek unspecified monetary damages and an order directing the Company to adopt certain measures purportedly designed to improve its corporate governance and internal procedures. On January 8, 2014, the parties reached an agreement in principle to resolve all claims in exchange for corporate governance reforms and payment of attorneys' fees in the amount of \$5.25 million, to be paid by the Company's and HeathpointCapital's respective insurance carriers. The Company believes the claims are without merit and, subject to final approval of any

settlement, intends to vigorously defend itself against these complaints. No assurances can be given as to the timing or outcome of this lawsuit. For a more detailed description of this matter, please see "Item 3 Legal Proceedings".

#### Risks Related to Our Common Stock

We expect that the price of our common stock will fluctuate substantially and the market price of our common stock may decline in value in the future.

The market price of our common stock is likely to be highly volatile and may fluctuate substantially due to many factors, including:

- volume and timing of orders for our products;
  - quarterly variations in our or our competitors' results of operations;
  - our announcement or our competitors' announcements regarding new products, product enhancements, significant contracts, number of distributors, number of hospitals and surgeons using products, acquisitions, collaborative or strategic investments;
  - announcements of technological or medical innovations for the treatment of spine pathology;
  - changes in earnings estimates or recommendations by securities analysts;
  - our ability to develop, obtain regulatory clearance or approval for, and market new and enhanced products on a timely basis;
  - changes in healthcare policy in the U.S. and internationally;
  - product liability claims or other litigation involving us;
  - sales of large blocks of our common stock, including sales by our executive officers, directors and significant stockholders;
    - changes in governmental regulations or in the status of our regulatory approvals, clearances or applications;
  - disputes or other developments with respect to intellectual property rights;
  - changes in the availability of third-party reimbursement in the U.S. or other countries;
  - changes in accounting principles; and
  - general market conditions and other factors, including factors unrelated to our operating performance or the operating performance of our competitors.
- We may become involved in additional securities class action litigation that could divert management's attention and harm our business.
- The stock market in general, The NASDAQ Global Select Market and the market for medical device companies in particular, has experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of those companies. Further, the market prices of securities of medical device companies have been particularly volatile. In the past, following periods of volatility in the market price of a particular company's securities, securities class action litigation has often been brought against that company. We may become involved in this type of litigation in the future. Litigation is often expensive and diverts management's attention and resources, which could materially harm our financial condition, results of operations and business.



Securities analysts may not continue to provide coverage of our common stock or may issue negative reports, which may have a negative impact on the market price of our common stock.

Securities analysts may not continue to provide research coverage of our common stock. If securities analysts do not cover our common stock, the lack of research coverage may cause the market price of our common stock to decline. The trading market for our common stock may be affected in part by the research and reports that industry or financial analysts publish about our business. If one or more of the analysts who elects to cover us downgrades our stock, our stock price would likely decline rapidly. If one or more of these analysts ceases coverage of us, we could lose visibility in the market, which in turn could cause our stock price to decline. In addition, rules mandated by the Sarbanes-Oxley Act and a global settlement reached in 2003 between the SEC, other regulatory agencies and a number of investment banks have led to a number of fundamental changes in how analysts are reviewed and compensated. In particular, many investment banking firms are required to contract with independent financial analysts for their stock research. It may be difficult for companies such as ours, with smaller market capitalizations, to attract independent financial analysts that will cover our common stock. This could have a negative effect on the market price of our stock.

Because of their significant stock ownership, our executive officers, directors and principal stockholders will be able to exert control over us and our significant corporate decisions.

Based on shares outstanding at March 19, 2014, our executive officers, directors and stockholders holding more than 5% of our outstanding common stock and their affiliates, in the aggregate, beneficially own approximately 31% of our outstanding common stock. As a result, these persons will have the ability to impact significantly the outcome of all matters requiring stockholder approval, including the election and removal of directors and any merger, consolidation, or sale of all or substantially all of our assets.

This concentration of ownership may harm the market price of our common stock by, among other things:

- delaying, deferring or preventing our change in control;
- impeding a merger, consolidation, takeover or other business combination involving us;
- causing us to enter into transactions or agreements that are not in the best interests of all of our stockholders; or
- reducing our public float held by non-affiliates.

Certain members of our Board of Directors also serve as officers and directors of HealthpointCapital, its affiliates and other portfolio companies.

Four members of our Board of Directors also serve as officers and directors of our largest stockholder, HealthpointCapital, or its related entities and of other companies in which HealthpointCapital invests, including companies with which we compete or may in the future compete. As of March 19, 2014, HealthpointCapital owned approximately 30% of our outstanding common stock. The Chairman of our Executive Committee of our Board of Directors, Mortimer Berkowitz III, is a managing member of HGP, LLC and HGP II, LLC, the general partners of HealthpointCapital Partners, LP and HealthpointCapital Partners II, LP, respectively. John H. Foster, a member of our Board of Directors, is a managing member of HGP, LLC and HGP II, LLC and the Chairman, Chief Executive Officer, a member of the Board of Managers and a Managing Director of HealthpointCapital, LLC. Our directors R. Ian Molson and Stephen E. O'Neil also serve on the board of managers of HealthpointCapital, LLC. Each of Messrs. Berkowitz, Foster, O'Neil and Molson, also have financial interests in HealthpointCapital investment funds. James Glynn has made a passive investment in HealthpointCapital investment funds. Mr. Glynn does not have any decision-making authority with respect to how such amount is invested and managed by HealthpointCapital.

Because of these possible conflicts of interest, such directors may direct potential business and investment opportunities to other entities rather than to us or such directors may undertake or otherwise engage in activities or conduct on behalf of such other entities that is not in, or which may be adverse to, our best interests. Whether a director directs an opportunity to us or to another company, our directors may face claims of breaches of fiduciary duty and other duties relating to such opportunities. Our amended and restated certificate of incorporation requires us to indemnify our directors to the fullest extent permitted by law, which may require us to indemnify them against claims of breaches of such duties arising from their service on our Board of Directors. HealthpointCapital or its affiliates may pursue acquisition opportunities that may be complementary to our business and, as a result, those

acquisition opportunities may not be available to us. Furthermore, HealthpointCapital may have an interest in us pursuing acquisitions, divestitures, financings or other transactions that, in its judgment, could enhance its equity investment, even though such transactions might involve risks to us and our stockholders generally. In addition, if we were to seek a business combination with a target business with which one or more of our existing stockholders or directors

may be affiliated, conflicts of interest could arise in connection with negotiating the terms of and completing the business combination. Conflicts that may arise may not be resolved in our favor.

Anti-takeover provisions in our organizational documents and change of control provisions in some of our employment agreements and agreements with distributors, and in some of our outstanding debt agreements, as well as the terms of our redeemable preferred stock, may discourage or prevent a change of control, even if an acquisition would be beneficial to our stockholders, which could affect our stock price adversely.

Certain provisions of our amended and restated certificate of incorporation and restated by-laws could discourage, delay or prevent a merger, acquisition or other change in control that stockholders may consider favorable, including transactions in which our stockholders might otherwise receive a premium for their shares. These provisions also could limit the price that investors might be willing to pay in the future for shares of our common stock, thereby depressing the market price of our common stock. Stockholders who wish to participate in these transactions may not have the opportunity to do so. Furthermore, these provisions could prevent or frustrate attempts by our stockholders to replace or remove our management. These provisions:

- allow the authorized number of directors to be changed only by resolution of our Board of Directors;
- allow vacancies on our Board of Directors to be filled only by resolution of our Board of Directors;
- authorize our Board of Directors to issue, without stockholder approval, blank check preferred stock that, if issued, could operate as a "poison pill" to dilute the stock ownership of a potential hostile acquirer to prevent an acquisition that is not approved by our Board of Directors;
- require that stockholder actions must be effected at a duly called stockholder meeting and prohibit stockholder action by written consent;
- establish advance notice requirements for stockholder nominations to our Board of Directors and for stockholder proposals that can be acted on at stockholder meetings; and
- limit who may call stockholder meetings.

Some of our employment agreements and all of our restricted stock agreements and incentive stock option agreements provide for accelerated vesting of benefits, including full vesting of restricted stock and options, upon a change of control. A limited number of our agreements with our distributors include a provision that extends the term of the distribution agreement upon a change in control and makes it more difficult for us or our successor to terminate the agreement. These provisions may discourage or prevent a change of control.

In addition, in the event of a change of control, we would be required to redeem all outstanding shares of our redeemable preferred stock for an aggregate of \$29.9 million, at the price of \$9.00 per share. Further, our amended and restated certificate of incorporation permits us to issue additional shares of preferred stock. The terms of our redeemable preferred stock or any new preferred stock we may issue could have the effect of delaying, deterring or preventing a change in control.

#### SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K and, in particular, the description of our "Business" set forth in Item 1, the "Risk Factors" set forth in this Item 1A and our "Management's Discussion and Analysis of Financial Condition and Results of Operations" set forth in Item 7 contain or incorporate a number of forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Exchange Act, including statements regarding:

- our estimates regarding anticipated operating losses, future revenue, expenses, capital requirements, and liquidity, including our anticipated revenue growth and cost savings;
- our ability to market, improve, grow, commercialize and achieve market acceptance of any of our products or any product candidates that we are developing or may develop in the future;
- the effect of our strategy to streamline our organization and lower our costs, including the effect of the restructuring of our French operations, on the financial condition and operations of our business;
- our ability to successfully integrate, and realize benefits from acquisitions;
- our ability to successfully achieve and maintain regulatory clearance or approval for our products in applicable jurisdictions and in a timely manner;



the effect of any existing or future federal, state or international regulations on our ability to effectively conduct our business;

our estimates of market sizes and anticipated uses of our products, including the market size of the aging spine market and our ability to successfully penetrate such market;

our business strategy and our underlying assumptions about market data, demographic trends, reimbursement trends, pricing trends, and trends relating to customer collections;

our ability to achieve profitability, and the potential need to raise additional funding;

our ability to maintain an adequate sales network for our products, including to attract and retain independent distributors;

our ability to enhance our U.S. and international sales networks and product penetration;

our ability to attract and retain a qualified management team, as well as other qualified personnel and advisors;

our ability to enter into licensing and business combination agreements with third parties and to successfully integrate the acquired technology and/or businesses;

our management team's ability to accommodate growth and manage a larger organization;

our ability to protect our intellectual property, and to not infringe upon the intellectual property of third parties;

our ability to maintain compliance with the quality requirements of the FDA and similar regulatory authorities outside of the U.S.;

our ability to meet the financial covenants under our credit facilities;

our ability to conclude that we have effective disclosure controls and procedures;

our ability to meet or exceed the industry standard in clinical and legal compliance and corporate governance programs;

potential liability resulting from litigation;

potential liability resulting from a governmental review of our business practices;

potential liability from not meeting the payment obligations under either the Cross Medical or Orthotec settlements; and

other factors discussed elsewhere in this Annual Report on Form 10-K or any document incorporated by reference herein or therein.

Any or all of our forward-looking statements in this Annual Report may turn out to be wrong. They can be affected by inaccurate assumptions by known or unknown risks and uncertainties. Many factors mentioned in our discussion in this Annual Report on Form 10-K will be important in determining future results. Consequently, no forward-looking statement can be guaranteed. Actual future results may vary materially from expected results.

We also provide a cautionary discussion of risks and uncertainties under "Risk Factors" in Item 1A of this Annual Report. These are factors that we think could cause our actual results to differ materially from expected results. Other factors besides those listed there could also adversely affect us.

Without limiting the foregoing, the words "believe," "anticipate," "plan," "expect," "may," "could," "would," "seek," "intend," similar expressions are intended to identify forward-looking statements. There are a number of factors and uncertainties that could cause actual events or results to differ materially from those indicated by such forward-looking statements, many of which are beyond our control, including the factors set forth under "Item 1A Risk Factors." In addition, the forward-looking statements contained herein represent our estimate only as of the date of this filing and should not be relied upon as representing our estimate as of any subsequent date. While we may elect to update these forward-looking statements at some point in the future, we specifically disclaim any obligation to do so to reflect actual results, changes in assumptions or changes in other factors affecting such forward-looking statements.

Item 1B. Unresolved Staff Comments  
None.

## Item 2. Properties

Our corporate office and manufacturing facilities are located in Carlsbad, California. The table below provides selected information regarding our current material operating leased locations.

Location	Use	Approximate	
		Square Footage	Lease Expiration
Carlsbad, California	Corporate headquarters and product design	76,693	January 2016
Carlsbad, California	Product design and manufacturing	73,480	January 2017

## Item 3. Legal Proceedings

### Litigation

In 1998, Eurosururgical, a French company in the business of sales and marketing of spinal implants, entered into a distribution agreement for the United States, Mexico, Canada, India and Australia with Orthotec, LLC, a California company, or Orthotec. In 2004, Orthotec sued Eurosururgical in connection with a contractual dispute and a final \$9 million judgment was entered against Eurosururgical by a California court in 2006. In 2007, following a default judgment, a federal court in California declared Eurosururgical liable to Orthotec for \$30 million in connection with an intellectual property dispute. In 2006, Eurosururgical's European assets were ultimately acquired by Surgiview, SAS, or Surgiview, in a sale agreement, or the Partial Sale Agreement, approved by a French court. After this sale, Surgiview became a subsidiary of Scient'x in 2006. Orthotec attempted to recover on Eurosururgical's obligations by filing a motion in a California court to add Surgiview to the judgment against Eurosururgical on theories including successor liability and fraudulent conveyance. In February 2007, the California court denied Orthotec's motion, indicating that Orthotec had not carried its burdens of proof. Orthotec chose to not proceed with a further hearing in September 2007.

In June 2004, HealthpointCapital (Luxembourg) I S.à.r.l. acquired a minority (33.1 percent) interest in Scient'x. In July 2005, Scient'x acquired an approximately 73 percent interest in Surgiview. At that time, HealthpointCapital Partners, L.P. (through a Luxembourg subsidiary) held a minority interest in Scient'x, which in turn held an interest in Surgiview, but HealthpointCapital Partners II, L.P. had no ownership interest in Scient'x or Surgiview. On November 21, 2007, more than a year after the Partial Sale Agreement was executed, HealthpointCapital Partners II, L.P. acquired majority ownership of Scient'x. In May 2008, after the acquisition of Scient'x by HealthpointCapital in 2007, Orthotec sued Scient'x, Surgiview, HealthpointCapital LLC and certain former directors of Scient'x (who also serve on our board) in a new action in California state court in which it sought, in addition to damages related to other causes of action and punitive damages related thereto, to have the defendant's bear responsibility for the \$39 million in judgments that had been assessed against Eurosururgical, which, together with interest is now greater than \$70 million. On February 10, 2014 the jury reached a verdict in which Surgiview was found to have transferred assets for less than fair market value in connection with Surgiview's purchase of certain assets of Eurosururgical, and to have interfered with certain contractual rights of Orthotec. Although a formal judgment has not yet been entered, the jury awarded monetary damages in the amount of \$47.9 million, plus interest, against Surgiview related to various causes of action alleged by Orthotec.

In addition, also in May 2008, a similar action was filed in New York against HealthpointCapital, HealthpointCapital LLC, HealthpointCapital Partners, L.P., HealthpointCapital Partners II, L.P., Scient'x and two former directors of Scient'x (who also serve on our board), in which Orthotec sought, in addition to damages related to other causes of action and punitive damages related thereto, to have the defendant's bear responsibility for the \$39 million in judgments that had been assessed against Eurosururgical, which, together with interest is now greater than \$70 million. On March 15, 2014, we, Orthotec, LLC and certain other parties, including certain directors and affiliates of the Company, entered into a binding term sheet to settle all legal matters involving the Company and its directors and affiliates. Pursuant to the term sheet, we have agreed to pay Orthotec \$49 million in cash, with initial cash payments totaling \$1.75 million by March 31, 2014 and an additional \$15.75 million payment within 25 days of our closing a financing that would enable us to make such payment, but in no event no later than June 15, 2014. The remaining \$31.5 million will be paid to Orthotec in installments of \$1.1 million paid quarterly, beginning in the fourth quarter of

2014. HealthpointCapital has agreed to contribute \$5 million to the \$49 million settlement amount. In addition, a 7% simple interest rate will accrue on the unpaid portion of the \$31.5 million. All accrued interest is not payable until the \$49 million is paid, and such accrued interest shall be paid in \$1.1 million installments each quarter. This settlement will result in mutual releases of all claims and the dismissal of all Orthotec-related litigation matters involving the Company, its directors and affiliates.

On August 10, 2010, a purported securities class action complaint was filed in the United States District Court for the Southern District of California on behalf of all persons who purchased our common stock between December 19, 2009 and August 5, 2010 against us and certain of our directors and officers alleging violations of the Securities Exchange Act of 1934, as amended, and Rule 10b-5 promulgated thereunder. On February 17, 2011, an amended complaint was filed against us and certain of its directors and officers adding alleged violations of the Securities Act of 1933, as amended. HealthpointCapital, Jefferies & Company, Inc., Canaccord Adams, Inc., Cowen and Company, Inc., and Lazard Capital Markets LLC are also defendants in this action. The complaint alleges that the defendants made false or misleading statements, as well as failed to disclose material facts, about the Company's business, financial condition, operations and prospects, particularly relating to the Scient'x transaction and our financial guidance following the closing of the acquisition. The complaint seeks unspecified monetary damages, attorneys' fees, and other unspecified relief. We believe that the claims are without merit and we intend to vigorously defend ourselves against this complaint. However, the outcome of the litigation cannot be predicted at this time and any outcome that is adverse to us, regardless of who the defendant is, could have a significant adverse effect on our financial condition and results of operations.

On August 25, 2010, an alleged shareholder of the Company's filed a derivative lawsuit in the Superior Court of California, San Diego County, purporting to assert claims on behalf of the Company against all of its directors and certain of its officers and HealthpointCapital. Following the filing of this complaint, similar complaints were filed in the same court and in the U.S. District Court for the Southern District of California against the same defendants containing similar allegations. The complaint filed in federal court was dismissed by the plaintiff without prejudice in July 2011. The state court complaints have been consolidated into a single action and the Company has been named as a nominal defendant in the consolidated action. Each complaint alleges that the Company's directors and certain of its officers breached their fiduciary duties to the Company related to the Scient'x transaction, and by making allegedly false statements that led to unjust enrichment of HealthpointCapital and certain of the Company's directors. The complaints seek unspecified monetary damages and an order directing the Company to adopt certain measures purportedly designed to improve its corporate governance and internal procedures. On January 8, 2014, the parties reached an agreement in principle to resolve all claims in exchange for corporate governance reforms and payment of attorneys' fees in the amount of \$5.25 million, to be paid by the Company's and HeathpointCapital's respective insurance carriers. The Company believes the claims are without merit and, subject to final approval of any settlement, intends to vigorously defend itself against these complaints. No assurances can be given as to the timing or outcome of this lawsuit.

As of December 31, 2013, the probable outcome of any of the aforementioned litigation matters cannot be determined nor can we estimate a range of potential loss. Accordingly, in accordance with the authoritative guidance on the evaluation of contingencies, we have not recorded an accrual related to these litigation matters. The Company is and may become involved in various other legal proceedings arising from its business activities. While management does not believe the ultimate disposition of these matters will have a material adverse impact on our consolidated results of operations, cash flows or financial position, litigation is inherently unpredictable, and depending on the nature and timing of these proceedings, an unfavorable resolution could materially affect our future consolidated results of operations, cash flows or financial position in a particular period.

Item 4.  
Not applicable.

#### Mine Safety Disclosures



## PART II

## Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

## Market Information

Our common stock is traded on The NASDAQ Global Select Market under the symbol "ATEC." The following table sets forth the high and low sales prices for our common stock as reported on The NASDAQ Global Select Market for the periods indicated.

Year Ended December 31, 2013	High	Low
First quarter	\$2.40	\$1.55
Second quarter	2.10	1.71
Third quarter	2.41	1.92
Fourth quarter	2.15	1.75
Year Ended December 31, 2012	High	Low
First quarter	\$2.42	\$1.56
Second quarter	2.42	1.55
Third quarter	1.85	1.50
Fourth quarter	1.98	1.41

## Stockholders

As of March 19, 2014, there were approximately 300 holders of record of an aggregate 97,600,388 shares of our common stock.

## Dividend Policy

We have never declared or paid cash dividends on our capital stock. We currently intend to retain all available funds and any future earnings for use in the operation and expansion of our business and do not anticipate paying any cash dividends in the foreseeable future.

## Sales of Unregistered Securities

In 2012 and 2013, we entered into consulting agreements with a third-party entity for marketing and advertising services. In connection with these agreements, on July 31, 2012, October 9, 2012 and May 1, 2013, we issued 176,000, 176,000 and 225,000, respectively, unregistered shares of our common stock, par value \$0.0001 per share, or the Stock Consideration. We did not receive any cash proceeds from the issuances of the Stock Consideration. The Stock Consideration was issued in reliance upon an exemption from registration under federal securities laws provided by Section 4(2) of the Securities Act, for the issuance and exchange of securities in transactions by an issuer not involving a public offering. We do not have an obligation, nor does it anticipate, registering the Stock Consideration for resale on a registration statement pursuant to the Securities Act.

In October 2013, we entered into a three-year collaboration agreement with a third party to provide consultation services to assist us in the development of our products and products in development. Under the terms of the collaboration agreement, we will gain exclusive rights to the use of all intellectual property developed by the collaborators. We will make three annual payments to the collaborator as sole consideration for services provided, totaling an aggregate of up to \$8 million, paid in our common stock at a per share price of \$1.95, which was equal to the average NASDAQ closing price of the common stock on the five days leading up to and including the date of signing the collaboration agreement. The actual number of shares issued each year will be determined by the fair market value of the services provided over the prior 12 months. In 2013, we issued 128,571 shares of common stock under this agreement.

Issuer Purchases of Equity Securities

Under the terms of our Amended and Restated 2005 Employee, Director and Consultant Stock Plan, or the Stock Plan, we may award shares of restricted stock to our employees, directors and consultants. These shares of restricted stock are subject to a lapsing right of repurchase by us. We may exercise this right of repurchase in the event that a restricted stock recipient's employment, directorship or consulting relationship with us terminates prior to the end of the vesting period. If we exercise this right, we are required to repay the purchase price paid by or on behalf of the recipient for the repurchased restricted shares. Repurchased shares are returned to the Stock Plan and are available for future awards under the terms of the Stock Plan. Common shares repurchased during the quarter ended December 31, 2013 were as follows:

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as part of Publicly Announced Plans or Programs	Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs
October 2013	—	\$—	—	—
November 2013	—	\$—	—	—
December 2013	—	\$—	—	—

Not included in the table above are 23,634 shares of common stock forfeited and retired in connection with the payment of minimum statutory withholding taxes due upon the vesting of certain stock awards or the exercise of certain stock options. In lieu of making a cash payment with respect to such withholding taxes, the holders of such stock forfeited a number of shares at the then current fair market value to pay such taxes.



Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion of our financial condition and results of operations should be read in conjunction with the financial statements and the notes to those statements appearing elsewhere in this Annual Report on Form 10-K. Our management's discussion and analysis of our financial condition and results of operations include the identification of certain trends and other statements that may predict or anticipate future business or financial results that are subject to important factors that could cause our actual results to differ materially from those indicated. See "Item 1A Risk Factors" included elsewhere in this Annual Report on Form 10-K.

Overview

We are a medical technology company focused on the design, development, manufacturing and marketing of products for the surgical treatment of spine disorders. We have a comprehensive product portfolio and pipeline that addresses the cervical, thoracolumbar and intervertebral regions of the spine and covers a variety of major spinal disorders and surgical procedures. Our principal product offerings are focused on the global market for orthopedic spinal disorder solutions. Our "physician-inspired culture" enables us to respond to changing surgeon needs through collaboration with spinal surgeons to conceptualize, design and co-develop a broad range of products. We have a state-of-the-art, in-house manufacturing facility that provides us with a unique competitive advantage, and enables us to rapidly deliver solutions to meet surgeons' and patients' critical needs. We believe that our products and systems have enhanced features and benefits that make them attractive to surgeons and that our broad portfolio of products and systems provide a comprehensive solution for the safe and successful surgical treatment of spinal disorders.

Revenue and Expense Components

The following is a description of the primary components of our revenues and expenses:

**Revenues.** We derive our revenues primarily from the sale of spinal surgery implants used in the treatment of spine disorders. Spinal implant products include spine screws and complementary products, vertebral body replacement devices, plates, products to treat vertebral compression fractures and bone grafting materials. Our revenues are generated by our direct sales force and independent distributors. Our products are requested directly by surgeons and shipped and billed to hospitals and surgical centers. Today we have existing subsidiaries and/or affiliates in Japan, Germany, Brazil, Hong Kong, Italy and the U.K. through which we sell our products and independent distributors in over 50 countries throughout the world. A majority of our business is conducted with customers within markets in which we have experience and with payment terms that are customary to our business. If we offer payment terms greater than our customary business terms or begin operating in a new market, revenues are deferred until the earlier of when payments become due or cash is received from the related distributors.

**Cost of revenues.** Cost of revenues consists of direct product costs, royalties, milestones, depreciation of our surgical instruments, and the amortization of purchased intangibles. We manufacture substantially all of the non-tissue-based implants that we sell. Our product costs consist primarily of direct labor, manufacturing overhead, and raw materials and components. The product costs of certain of our biologics products include the cost of procuring and processing human tissue. We incur royalties related to the technologies that we license from others and the products that are developed in part by surgeons with whom we collaborate in the product development process. Amortization of purchased intangibles consists of amortization of developed product technology.

**Research and development.** Research and development expense consists of costs associated with the design, development, testing, and enhancement of our products. Research and development expense also includes salaries and related employee benefits, research-related overhead expenses, fees paid to external service providers, and costs associated with our Scientific Advisory Board and Executive Surgeon Panels.

**In-process research and development, or IPR&D.** IPR&D expense consists of acquired research and development assets that were not part of an acquisition of a business and were not technologically feasible on the date we acquired such technology, provided that such technology did not have any alternative future use at that date, or IPR&D assets acquired in connection with a business acquisition that are determined to have no alternative future use. At the time of acquisition, we expect all acquired IPR&D will reach technological feasibility in the future, but there can be no assurance that commercial viability of a product will be achieved. The nature of the efforts to develop the acquired technologies into commercially viable products consists principally of planning, designing, and obtaining regulatory clearances. The risks associated with achieving commercialization include, but are not limited to, delays or failures

during the development process, delays or failures to obtain regulatory clearances, and delays or failures due to intellectual property rights of third parties.

Sales and marketing. Sales and marketing expense consists primarily of salaries and related employee benefits, sales commissions and support costs, professional service fees, travel, medical education, trade show and marketing costs.

General and administrative. General and administrative expense consists primarily of salaries and related employee benefits, professional service fees, insurance and legal expenses.

Transaction related expenses. Transaction related expenses consist of legal, accounting and financial advisory fees associated with acquisitions.

Restructuring expenses. Restructuring expenses consist of severance, social plan benefits and related taxes, facility closing costs, manufacturing transfer costs and contract termination incurred in connection with the reorganization of the Scient'x operations in France.

Litigation settlement expenses. Litigation settlement expenses consist of significant settlements of lawsuits.

Total other income (expense). Total other income (expense) includes interest income, interest expense, gains and losses from foreign currency exchanges and other non-operating gains and losses.

Income tax provision (benefit). Income tax provision (benefit) consists primarily of income tax provision related to state income taxes, foreign operations and uncertain tax positions in foreign jurisdictions, the income tax benefits are primarily due to the tax effect of changes in deferred tax liabilities associated with tax deductible goodwill.

### Results of Operations

The first table below sets forth our statements of operations data for the periods presented. Our historical results are not necessarily indicative of the operating results that may be expected in the future.

	Year Ended December 31,		
	2013	2012	2011
	(in thousands)		
Revenues	\$204,724	\$196,278	\$197,711
Cost of revenues	78,669	70,761	79,168
Amortization of acquired intangible assets	1,733	1,749	1,613
Gross profit	124,322	123,768	116,930
Operating expenses:			
Research and development	14,190	14,886	16,888
In-process research and development	—	341	—
Sales and marketing	76,960	75,177	75,189
General and administrative	47,949	39,939	36,367
Amortization of acquired intangible assets	3,009	2,180	2,152
Transaction related expenses	—	1,082	—
Restructuring expenses	9,665	—	1,050
Litigation settlement expenses	45,982	—	9,800
Total operating expenses	197,755	133,605	141,446
Operating loss	(73,433	) (9,837	) (24,516
Other income (expense):			
Interest income	6	118	148
Interest expense	(3,959	) (6,105	) (3,027
Other income (expense), net	(1,662	) (794	) 707
Total other income (expense)	(5,615	) (6,781	) (2,172
Pretax net loss	(79,048	) (16,618	) (26,688
Income tax provision (benefit)	3,179	(1,159	) (4,507
Net loss	\$(82,227	) \$(15,459	) \$(22,181

Year Ended December 31, 2013 Compared to the Year Ended December 31, 2012

Revenues. Revenues were \$204.7 million for the year ended December 31, 2013 compared to \$196.3 million for the year ended December 31, 2012, representing an increase of \$8.4 million, or 4.3%. The increase was comprised of \$4.4 million related to sales in the United States and \$4.0 million related to international sales.

U.S. revenues were \$135.0 million for the year ended December 31, 2013 compared to \$130.5 million for the year ended December 31, 2012, representing an increase of \$4.5 million, or 3.4%. The increase was due to growth in the sales of implants and instruments (\$8.2 million) and Biologics (\$2.1 million), offset by a decline in the sales of Puregen due to the voluntary removal from the market (\$5.8 million).

International revenues were \$69.8 million for the year ended December 31, 2013 compared to \$65.8 million for the year ended December 31, 2012, representing an increase of \$4.0 million, or 6.0%. The increase was due to sales of Alphatec implants and instruments (\$6.5 million), offset by a reduction in the sales of Scient'x products (\$2.5 million). The increase in revenue is inclusive of \$5.9 million in unfavorable exchange rate effect.

Cost of revenues. Cost of revenues was \$78.7 million for the year ended December 31, 2013 compared to \$70.8 million for the year ended December 31, 2012, representing an increase of \$7.9 million, or 11.2%. The increase was primarily due to one-time charges for increased inventory and instrument reserves related to the restructuring of the Scient'x organization (\$5.5 million), the obsolescence of the Puregen inventory (\$3.5 million) and the obsolescence of certain inventory related to an interbody fusion MIS product (\$1.0 million). In addition to these charges, there is an increase related to higher product costs as a result of sales volume and variation in product mix (\$2.1 million), offset by an adjustment to milestone accruals (\$0.7 million), a reduction in inventory reserves (\$2.9 million) and a reduction in inventory adjustments and other costs of sales (\$0.4 million).

Amortization of acquired intangible assets. Amortization of acquired intangible assets was \$1.7 million for the years ended December 31, 2013 and December 31, 2012. This expense represents amortization in the period for intangible assets associated with product related assets obtained in acquisitions.

Gross profit. Gross profit was \$124.3 million for the year ended December 31, 2013 compared to \$123.8 million for the year ended December 31, 2012, representing an increase of \$0.6 million, or 0.4%. The increase was due to an increase in sales volume (\$6.8 million), a reduction in inventory reserves (\$2.9 million), a reversal of milestone accruals (\$0.7 million) and a decrease in other cost of revenues (\$0.6 million), offset by an increase in the cost of revenues resulting from the restructuring (\$5.5 million), product obsolescence (\$4.5 million) and an unfavorable variation in product mix (\$0.4 million).

Gross margin. Gross margin was 60.7% for the year ended December 31, 2013 compared to 63.1% for the year ended December 31, 2012. The decrease of 2.4 percentage points was due to an increase in the cost of revenues resulting from the restructuring (2.6 percentage points), product obsolescence (2.2 percentage points) and an unfavorable variation in pricing and product mix (0.2 percentage points), offset by a reduction in inventory reserves (1.6 percentage points), an adjustment to milestone accruals (0.3 percentage points) and a reduction in other cost of revenues (0.7 percentage points).

Gross margin in the U.S. was 67.7% for the year ended December 31, 2013 compared to 68.5% for the year ended December 31, 2012. The decrease of 0.8 percentage points was due to an increase in the cost of revenues resulting from product obsolescence (3.2 percentage points), offset by a favorable variation in pricing and product mix (0.3 percentage points), a reduction in inventory adjustments (1.1 percentage points) and reduction in other cost of revenues (1.0 percentage points).

Gross margin for the International region was 47.3% for the year ended December 31, 2013 compared to 52.3% for the year ended December 31, 2012. The decrease of 5.0 percentage points was due to an increase in the cost of revenues resulting from the restructuring (7.9 percentage points) and an unfavorable variation in pricing and product mix (0.8 percentage points), offset by a reduction in inventory reserves (3.8 percentage points).

Research and development. Research and development expense was \$14.2 million for the year ended December 31, 2013 compared to \$14.9 million for the year ended December 31, 2012 representing a decrease of \$0.7 million, or 4.7%. The decrease was primarily related to the variations in the timing of the cycle for development and testing (\$1.4 million), offset by increased surgeon consulting expenses (\$0.7 million).

In-process research and development. IPR&D expense was \$0.0 million for the year ended December 31, 2013 compared to \$0.3 million for the year ended December 31, 2012. During the fourth quarter of 2012, the Company decided that it would not pursue development of IPR&D assets that had an indefinite life. The Company expensed \$0.3 million for IPR&D related to the write-off of a portion of the IPR&D assets acquired in the Scient'x acquisition. Sales and marketing. Sales and marketing expense was \$77.0 million for the year ended December 31, 2013 compared to \$75.2 million for the year ended December 31, 2012 representing an increase of \$1.8 million, or 2.4%. The increase was primarily due to the additional expense created by the recently enacted medical device excise tax (\$1.5 million).



General and administrative. General and administrative expense was \$47.9 million for the year ended December 31, 2013 compared to \$39.9 million for the year ended December 31, 2012, representing an increase of \$8.0 million, or 20.1%. The increase was primarily related to legal fees associated with litigation and product liability claims (\$5.4 million), compensation expense (\$2.1 million), professional fees (\$1.3 million) and expenses resulting from the Phygen acquisition (\$0.4 million), offset by a decrease in International expenses related to currency translation (\$0.8 million) and general cost reduction (\$0.4 million).

Amortization of acquired intangible assets. Amortization of acquired intangible assets was \$3.0 million for the year ended December 31, 2013 compared to \$2.2 million for the year ended December 31, 2012, representing an increase of \$0.8 million, or 38.0%. This expense represents amortization in the period for intangible assets associated with general business assets obtained in acquisitions.

Transaction related expenses. Transaction related expenses were \$0.0 million for the year ended December 31, 2013 compared to \$1.1 million for the year ended December 31, 2012. The transaction related expenses were due to legal and professional fees in connection with the Company's asset acquisition of Phygen, LLC in 2012.

Restructuring expenses. Restructuring expenses were \$9.7 million for the year ended December 31, 2013 compared to \$0.0 million for the year ended December 31, 2012. On September 16, 2013, we announced that Scient'x had begun a process to significantly restructure its business operations in France in an effort to improve operating efficiencies and rationalize its cost structure. The restructuring includes an expected reduction in Scient'x's workforce and closing of the manufacturing facilities in France. We recorded restructuring costs of \$9.7 million for the year ended December 31, 2013 and there was no corresponding expense for the year ended December 31, 2012. We estimate that we will record total costs, including employee severance, social plan benefits and related taxes, facility closing costs, manufacturing transfer costs and contract termination costs of approximately \$12 million associated with this restructuring. We expect to complete all the activities associated with the restructuring activities by the end of the second quarter of 2014, a substantial portion of which will be paid by then.

Litigation settlement expenses. Litigation settlement expenses were \$46.0 million for the year ended December 31, 2013. The 2013 amount relates to an accrual booked for litigation settlement in connection with the Orthotec LLC, litigation matter described in Part 1 Item 3 Legal Proceedings.

Interest income. Interest income was \$0.0 million for the years ended December 31, 2013 compared to \$0.1 million for the year ended December 31, 2012. Interest income is earned on cash balances held in accounts invested in money market funds.

Interest expense. Interest expense was \$4.0 million for the year ended December 31, 2013 compared to \$6.1 million for the year ended December 31, 2012, representing a decrease of \$2.1 million, or 35.2%. Interest expense for the year ended December 31, 2013 consisted primarily of interest related to loan agreements and lines of credit and the associated amortization expenses related to debt issuance costs. Interest expense for the year ended December 31, 2012 included a loss on extinguishment of debt costs of \$2.9 million related to the refinancing of the term note and revolving credit facility with Silicon Valley Bank, which consisted of \$2.3 million of early termination fees and \$0.6 million for the write-off of capitalized deferred debt offering costs.

Other income (expense), net. Other income (expense) was an expense of \$(1.7) million for the year ended December 31, 2013 compared to an expense of \$(0.8) million for the year ended December 31, 2012, representing an increase in expense of \$(0.9) million. The increase in expense was primarily due to unfavorable foreign currency exchange results realized in 2013 due to having U.S. denominated assets and liabilities on our foreign subsidiaries books as compared to 2012.

Income tax provision (benefit). Income tax provision (benefit) was a provision of \$3.2 million for the year ended December 31, 2013 compared to a benefit of \$(1.2) million for the year ended December 31, 2012, representing an increase of \$4.3 million, or 374.3%. The income tax provision in 2013 consists primarily of income tax provisions related to state income taxes, the tax effect of changes in deferred tax liabilities associated with tax deductible goodwill and operations in foreign jurisdictions where we operate. The income tax benefit in 2012 consists primarily of tax benefits related to operations in France and a settlement with the French tax authorities partially offset by a valuation allowance on the French deferred tax assets, income tax expense for various other foreign jurisdictions, state income taxes and the tax effect of changes in deferred tax liabilities associated with tax deductible goodwill.



Year Ended December 31, 2012 Compared to the Year Ended December 31, 2011

Revenues. Revenues were \$196.3 million for the year ended December 31, 2012 compared to \$197.7 million for the year ended December 31, 2011, representing a decrease of \$1.4 million, or 0.7%. The decrease was a result of an increase in the International region of \$1.9 million, offset by a decrease in the U.S. of \$3.3 million.

U.S. revenues were \$130.5 million for the year ended December 31, 2012 compared to \$133.8 million for the year ended December 31, 2011, representing a decrease of \$3.3 million, or 2.5%. The decrease was due to a decrease in the sales of instruments and implants (\$9.4 million), offset by an increase in sales of Biologics (\$4.8 million) and the acquisition of Phygen (\$1.3 million).

International revenues were \$65.8 million for the year ended December 31, 2012 compared to \$63.9 million for the year ended December 31, 2011, representing an increase of \$1.9 million, or 3.0%. The growth was due to increased sales of Alphatec products (\$7.8 million), offset by a decrease in Scient'x products (\$5.9 million). The revenue from Alphatec product continues to grow as products in the aging Scient'x product portfolio are substituted with Alphatec products. The increase in revenues is inclusive of \$2.6 million in negative exchange rate effect.

Cost of revenues. Cost of revenues was \$70.8 million for the year ended December 31, 2012 compared to \$79.2 million for the year ended December 31, 2011, representing a decrease of \$8.4 million, or 10.6%. The decrease was primarily related to lower product costs as a result of a decrease in sales volume and variation in product mix (\$0.6 million), favorable manufacturing and absorption variances (\$6.5 million), a reduction to inventory adjustments (\$5.2 million), a reduction in instrument depreciation expense (\$0.5 million), a reduction in royalty and milestone expenses due to the cancellation of certain agreements, lower sales volumes and an adjustment to accruals (\$2.3 million), and a decrease in inventory step-up expense related primarily to the Scient'x acquisition (\$0.6 million), offset by an increase in the reserve for excess and obsolete inventory (\$3.1 million) and the amortization expenses associated with the settlement agreement we entered into in December 2011 with Biomet related to royalties on the sales of our polyaxial screws (\$4.2 million).

Amortization of acquired intangible assets. Amortization of acquired intangible assets was \$1.7 million for the years ended December 31, 2012 compared to \$1.6 million for the year ended December 31, 2011, representing an increase of \$0.1 million, or 8.4%. The increase primarily relates to amortization of intangible assets acquired in the Phygen acquisition.

Gross profit. Gross profit was \$123.8 million for the year ended December 31, 2012 compared to \$116.9 million for the year ended December 31, 2011, representing an increase of \$6.9 million, or 5.8%. The increase is due to a change in cost of revenues (\$7.9 million), offset by amortization of acquired intangibles (\$0.2 million) and a decrease in sales volume and variation in product mix (\$0.8 million).

Gross margin. Gross margin was 63.1% for the year ended December 31, 2012 compared to 59.1% for the year ended December 31, 2011. The increase of 3.9 percentage points was due to a reduction in the cost of revenues (3.7 percentage points) and a favorable variation in product mix (0.2 percentage points).

Gross margin for the U.S. was 68.5% for the year ended December 31, 2012 compared to 65.1% for the year ended December 31, 2011. The increase of 3.4 percentage points was due to reduced cost of revenues (\$7.5 million), offset by a negative variation in revenue volume and product mix (\$5.3 million).

Gross margin for the International region was 52.3% for the year ended December 31, 2012 compared to 46.7% for the year ended December 31, 2011. The increase of 5.6 percentage points was the result of a favorable variation in revenue volume and product mix (\$4.5 million).

Research and development. Research and development expense was \$14.9 million for the year ended December 31, 2012 compared to \$16.9 million for the year ended December 31, 2011, representing a decrease of \$2.0 million, or 11.9%. The decrease was primarily related to reduced European research and development activities to support the Scient'x products (\$1.7 million), reorganized management structure in the U.S. (\$0.3 million), and reduced activity due to the variation in the timing of the cycle for development and testing (\$0.4 million), offset by increased spending on clinical study and trial activity (\$0.4 million).

In-process research and development. IPR&D expense was \$0.3 million for the year ended December 31, 2012 compared to \$0.0 million for the year ended December 31, 2011. During the fourth quarter of 2012, the Company decided that it would not pursue development of in-process research and development assets that had an indefinite

life. The Company expensed \$0.3 million as in-process research and development related to the write-off of a portion of the in-process research and development assets acquired in the Scient'x acquisition.

Sales and marketing. Sales and marketing expense was \$75.2 million for the years ended December 31, 2012 and December 31, 2011. In 2012, expenses increased as a result of sales growth in Japan (\$1.8 million), but were offset by a reduction in commission expense related to a decrease in U.S. revenue (\$0.6 million), a reduction in post marketing clinical trial expenses (\$0.6 million), and a reduction in meeting expenses (\$0.6 million).

General and administrative. General and administrative expense was \$39.9 million for the year ended December 31, 2012 compared to \$36.4 million for the year ended December 31, 2011, representing an increase of \$3.5 million, or 9.8%. The increase was primarily related to increased litigation expense (\$2.0 million), increased expenses related to executive management and consulting costs (\$1.5 million), the operating expenses related to the Phygen acquisition (\$1.0 million) and severance costs (\$0.7 million), offset by a reduction in sales and use tax accruals (\$0.7 million) a reduction in recruiting fees (\$0.6 million) and a reduction in information technology related expenses (\$0.5 million). Amortization of acquired intangible assets. Amortization of acquired intangible assets was \$2.2 million for the years ended December 31, 2012 and December 31, 2011. This expense represents amortization in the period for intangible assets associated with general business assets obtained in the Scient'x and Phygen acquisitions.

Transaction related expenses. Transaction related expenses were \$1.1 million for the year ended December 31, 2012 compared to \$0.0 million for the year ended December 31, 2011. The transaction-related expenses were for legal, accounting and financial advisory fees associated with the asset acquisition of Phygen, LLC.

Restructuring expenses. Restructuring expenses was \$1.1 million for the year ended December 31, 2011. The restructuring expenses were due to severance and other personnel costs incurred in connection with restructuring activities in the United States and Europe.

Litigation settlement expenses. Litigation settlement expenses were \$9.8 million for the year ended December 31, 2011. The expense was due to a settlement agreement we entered into in December 2011 with Biomet. The amount expensed in 2011 represents the allocated value of the settlement and past royalties element due from the sale of our polyaxial screws. There was no corresponding litigation settlement expense in 2012.

Interest income. Interest income was \$0.1 million for the years ended December 31, 2012 and December 31, 2011. Interest income is earned on cash balances held in accounts invested in money market funds.

Interest expense. Interest expense was \$6.1 million for the year ended December 31, 2012 compared to \$3.0 million for the year ended December 31, 2011, representing an increase of \$3.1 million, or 101.7%. Interest expense consisted primarily of interest related to loan agreements and lines of credit. The expense in 2012 includes loss on extinguishment of debt costs of \$2.9 million related to the refinancing of the term note and revolving credit facility with Silicon Valley Bank consisting of \$2.3 million of early termination fees and \$0.6 million for the write-off of capitalized deferred debt offering costs.

Other income (expense), net. Other income (expense) was an expense of \$(0.8) million for the year ended December 31, 2012 compared to income of \$0.7 million for the year ended December 31, 2011. The decrease was due to unfavorable foreign currency exchange results realized in 2012 as compared to favorable results in 2011.

Income tax provision (benefit). Income tax provision (benefit) was a benefit of \$(1.2) million for the year ended December 31, 2012 compared to a benefit of \$(4.5) million for the year ended December 31, 2011, representing an increase of \$3.3 million, or 74.3%. The 2012 benefit for income taxes primarily consists of benefits associated with the Company's French operations and the reversal of the valuation allowance against the Japanese deferred tax assets partially offset by an increase in uncertain tax positions associated with the European operations and an increase in the goodwill deferred tax liability. The 2011 benefit for income taxes consists primarily of income tax benefits related to a French income tax settlement and acquired Scient'x operations, offset by state income taxes and the tax effect of changes in deferred tax liabilities associated with tax deductible goodwill.

#### Non-GAAP Financial Measures

We utilize certain financial measures that are not calculated based on Generally Accepted Accounting Principles, or GAAP. Certain of these financial measures are considered "non-GAAP" financial measures within the meaning of Item 10 of Regulation S-K promulgated by the SEC. We believe that non-GAAP financial measures reflect an additional way of viewing aspects of our operations that, when viewed with the GAAP results, provide a more complete understanding of our results of operations and the factors and trends affecting our business. These non-GAAP financial measures are also used by our management to evaluate financial results and to plan and forecast future periods. However, non-GAAP financial measures should be considered as a supplement to, and not as a substitute for, or superior to, the corresponding measures calculated in accordance with GAAP. Non-GAAP financial measures used by us may differ from the non-GAAP measures used by other companies, including our competitors.

Adjusted EBITDA represents net income (loss) excluding the effects of interest, taxes, depreciation, amortization, stock-based compensation and other non-recurring income or expense items, such as in-process research and development expense and acquisition related transaction expenses, restructuring expenses, litigation exposure expenses, trial related legal costs and litigation settlement expenses. We believe that the most directly comparable GAAP financial measure to adjusted EBITDA is net income (loss). Adjusted EBITDA has limitations, however, and therefore, should not be considered either in isolation or as a

substitute for analysis of our results as reported under GAAP. Furthermore, adjusted EBITDA should not be considered as an alternative to operating income (loss) or net income (loss) as a measure of operating performance or to net cash provided by operating, investing or financing activities, or as a measure of our ability to meet cash needs. The following is a reconciliation of adjusted EBITDA to the most comparable GAAP measure, net loss, for the years ended December 31, 2013, 2012 and 2011 (in thousands):

	Year Ended December 31,		
	2013	2012	2011
Net loss	\$(82,227	) \$(15,459	) \$(22,181
Stock-based compensation	4,078	3,540	2,425
Depreciation	14,638	14,184	14,789
Amortization of intangible assets	6,898	5,679	1,322
Amortization of acquired intangible assets	4,741	3,929	3,765
In-process research and development	—	341	—
Interest expense, net	3,953	5,987	2,879
Income tax provision (benefit) expense	3,179	(1,159	) (4,507
Other (income) expense, net	1,662	794	(707
Acquisition-related inventory step up	—	191	751
Transaction related expenses	—	1,082	—
Restructuring and other expenses	18,603	794	1,050
Litigation expenses and trial costs	49,657	—	9,800
Adjusted EBITDA	\$25,182	\$19,903	\$9,386

#### Liquidity and Capital Resources

At December 31, 2013, our principal sources of liquidity consisted of cash of \$21.3 million and accounts receivable, net of \$41.4 million. Based on our operating plan and cash forecast, management believes that on a combined basis, such amounts will be sufficient to fund our projected operating requirements through at least December 31, 2014. We expect to fund the French Scient'x restructuring expenses and Orthotec settlement from available cash, cash flow from operating activity and unused availability under the revolving credit and term loan with MidCap Financial, LLC, or MidCap, and a facility agreement with Deerfield (as defined below) entered into subsequent to December 31, 2013. On June 7, 2012, we entered into a credit facility, or the Credit Facility, with MidCap, which was amended and restated on August 30, 2013 to, among other things, increase the borrowing limit from \$50 million to \$73 million. The Credit Facility is due in August 2016 and consists of a revolving line of credit with a maximum borrowing base of \$40 million and a \$28 million term loan with an additional \$5 million delayed draw for 12 months. The revolving line bears an interest rate equal to the London Interbank Market Rate, or LIBOR, plus 6.0% and the term loan bears an interest rate of LIBOR plus 8.0%, subject to a 9.5% floor. As of December 31, 2013, approximately \$52.1 million in principal amount was outstanding under the Credit Facility, with approximately \$15 million of unused availability under the revolving line of credit.

The Credit Facility contains certain financial covenants which require us to maintain a certain fixed charge coverage ratio and a senior leverage ratio in order to avoid default under the Credit Facility. We were in compliance with all of the covenants of the Credit Facility as of December 31, 2013. (See "Credit Facility and Other Debt" below).

Based on our current operating plan, we believe that we will be in compliance with our financial covenants under the Credit Facility for the foreseeable future. However, there is no assurance that we will be able to do so. If we are not able to achieve our planned revenue or if we incur costs in excess of our forecasts, we may be required to substantially reduce discretionary spending, and we could be in default of the Credit Facility. Upon the occurrence of an event of default which is not waived by MidCap, MidCap could declare the amounts outstanding under the Credit Facility immediately due and payable and refuse to extend further credit. If MidCap were to accelerate the repayment of borrowings under the Credit Facility, we may not have sufficient cash on hand to repay the amounts due under the Credit Facility and would have to seek to amend the terms of the Credit Facility or seek alternative financing. There can be no assurances that in the event of a default, a waiver could be obtained from MidCap, that the Credit Facility

could be successfully renegotiated or that we could modify our operations to maintain liquidity. If we are forced to seek additional financing, which may include additional debt and/or equity financing or funding through other third party agreements, there can be no assurances that additional financing will be available on favorable terms or available at all. Furthermore, any equity financing may result in dilution to existing stockholders and any debt financing may include restrictive covenants.



Historically, our principal sources of cash have included customer payments from the sale of our products, proceeds from the issuance of common and preferred stock and proceeds from the issuance of debt. Our principal uses of cash have included cash used in operations, acquisitions of businesses and intellectual property rights, payments relating to purchases of surgical instruments, repayments of borrowings under the Credit Facility and payments due under the Biomet settlement agreement. We expect that our principal uses of cash in the future will be for operations, working capital, capital expenditures, and potential acquisitions. We expect that, as our revenues grow, our sales and marketing and research and development expenses will continue to grow and, as a result, we will need to generate significant net revenues to achieve profitability. We anticipate that if we require additional liquidity for operations, it will be funded through borrowings under our revolving credit facility, the incurrence of other indebtedness, additional equity financings or a combination of these potential sources of liquidity.

We will need to invest in working capital and surgical instruments (the costs of which are capitalized) in order to support our revenue projections through the end of 2014. Should we not be able to achieve our revenue forecast and cash consumption starts to exceed forecasted consumption, management will need to adjust our investment in surgical instruments and manage our inventory to the decreased sales volumes. If we do not make these adjustments in a timely manner, there could be an adverse impact on our financial resources. Our revenue projections may be negatively impacted as a result of a decline in sales of our products, including declines due to changes in our customers' ability to obtain third-party coverage and reimbursement for procedures that use our products, increased pricing pressures resulting from intensifying competition, and cost increases and slower product development cycles resulting from a changing regulatory environment.

On March 15, 2014, we, Orthotec and certain other parties, including certain directors and affiliates of us entered into a binding term sheet to settle the pending litigation in the Orthotec, LLC vs Surgical S.A.S. legal matter and all other litigation matters related to us and our directors and affiliates. Pursuant to the term sheet we have agreed to pay Orthotec \$49 million in cash payments totaling \$1.75 million by March 31, 2014 and an additional \$15.75 million payment due within 25 days of the closing of the Facility Agreement (as defined below). The remaining \$31.5 million will be paid to Orthotec in 28 quarterly installments of \$1.1 million beginning in the fourth quarter of 2014.

HealthpointCapital has agreed to contribute \$5 million to the \$49 million settlement amount. In addition, a 7% simple interest rate will accrue on the unpaid portion of the \$31.5 million, which will be paid in \$1.1 million quarterly payments after the \$49 million is paid. We anticipate to fund a portion of the 2014 payment obligations with proceeds from the Facility Agreement described in the next paragraph.

On March 17, 2014, we entered into a Facility Agreement, or the Facility Agreement, with Deerfield Private Design Fund II, L.P., Deerfield Private Design International II, L.P., Deerfield Special Situations Fund, L.P., and Deerfield Special Situations International Master Fund, L.P., or collectively, Deerfield, pursuant to which Deerfield agreed to loan us up to \$50 million, subject to the terms and conditions set forth in the Facility Agreement, or the Financing. Under the terms of the Facility Agreement, we have the option, but is not required, upon certain conditions to draw the entire amount available under the Facility Agreement, at any time until January 30, 2015 provided that the initial draw be used for a portion of the payments made in connection with the Orthotec settlement described above, or the Litigation Satisfaction. Following such initial draw down, we may draw down additional amounts under the Facility Agreement up to an aggregate of \$15.0 million for working capital or general corporate purposes. In addition, in the event the Litigation Satisfaction has not occurred prior to December 15, 2014, we may request no later than January 30, 2015 a draw of the entire amount available under the Facility Agreement; provided that such amount will remain in a special deposit account until the Litigation Satisfaction occurs. We agreed to pay Deerfield, upon each disbursement of funds under the Facility Agreement, a transaction fee equal to 2.5% of the principal amount of the funds disbursed. On March 19, 2014, we drew \$20 million under the Facility Agreement and received net proceeds of \$19.5 million to fund the 2014 Orthotec settlement payment obligations.

A substantial portion of our available cash funds is held in business accounts with reputable financial institutions. At times, however, our deposits, may exceed federally insured limits and thus we may face losses in the event of insolvency of any of the financial institutions where our funds are deposited. Additionally, the capital markets have recently been highly volatile and there has been a lack of liquidity for certain financial instruments, especially those with exposure to mortgage-backed securities and auction rate securities. This lack of liquidity has made it difficult for

the fair value of these types of instruments to be determined. We did not hold any marketable securities as of December 31, 2013.

#### Operating Activities

We generated net cash of \$7.8 million from operating activities for the year ended December 31, 2013. During this period, net cash provided by operating activities primarily consisted of a net loss of \$82.2 million which was offset by a increase in working capital and other assets of \$45.0 million and \$45.1 million of non-cash costs including amortization, depreciation, deferred income taxes, stock-based compensation, provision for excess and obsolete inventory and interest expense related to amortization of debt discount and issue costs. The increase in working capital and other assets of \$45.0 million consisted of increases in accrued expenses and other liabilities of \$55.2 million, prepaid expenses and other current assets of \$0.5 million and other assets of \$0.1 million, partially offset by increases in inventory of \$4.4 million and accounts receivable of \$1.9 million and decreases in accounts payable of \$3.9 million and deferred revenue of 0.5 million.

#### Investing Activities

We used net cash of \$19.1 million in investing activities for the year ended December 31, 2013 primarily for the purchase of \$14.4 million in surgical instruments, computer equipment, leasehold improvements and manufacturing equipment, a \$4.0 million payment for the Phygen acquisition and \$0.8 million for the purchase of an intangible asset.

#### Financing Activities

Financing activities provided net cash of \$10.7 million for the year ended December 31, 2013. Payments net of borrowings under the Credit Facility revolving line of credit totaled \$14.2 million offset by borrowings under the Credit Facility term loan of \$28.0 million for the year ended December 31, 2013. We made principal payments on notes payable totaling \$2.7 million and capital leases totaling \$0.4 million for the year ended December 31, 2013.

#### Credit Facility and Other Debt

On August 30, 2013, we entered into an Amended and Restated Credit, Security and Guaranty Agreement with MidCap to, among other things, increase the borrowing limit from \$50 million to \$73 million. We also extended the maturity to August 2016. The Credit Facility consists of a \$28 million term loan drawn at closing with a \$5 million delayed draw within 12 months, for a total term loan maximum borrowing of \$33 million and a revolving line of credit with a maximum borrowing base of \$40 million. We used the term loan proceeds of \$28 million to repay a portion of the outstanding balance on the prior revolving line of credit. In addition to monthly payments of interest, monthly repayments of \$0.3 million of the principal for the term loan were made beginning in October 2013 and are due through maturity, with the remaining principal due upon maturity.

The term loan interest rate is priced at LIBOR plus 8.0%, subject to a 9.5% floor, and the revolving line of credit bears interest at LIBOR plus 6.0%, reset monthly. At December 31, 2013, the revolving line of credit carries an interest rate of 6.2% and the term loan carries an interest rate of 9.5%. The borrowing base is determined, from time to time, based on the value of domestic eligible accounts receivable and domestic eligible inventory. As collateral for the Credit Facility, we granted MidCap a security interest in substantially all of our assets, including all accounts receivable and all securities evidencing its interests in our subsidiaries. As of December 31, 2013 we had approximately \$15 million of unused availability under the revolving line of credit.

In January 2013, we entered into a limited waiver and limited consent agreement with MidCap, or Waiver. Under the waiver, MidCap gave us its consent to waive certain provisions of the prior Credit Facility in connection with the acquisition of Phygen and related to the maintenance of cash balances in the U.S. In February 2013, we entered into a first amendment to the prior Credit Facility with MidCap. The first amendment allowed us to exclude payments related to the Phygen acquisition and the settlement agreement with Cross Medical Products, LLC from calculation of the fixed charge coverage ratio and the senior leverage ratio. In conjunction with the first amendment, we paid MidCap a fee of \$0.1 million. In July 2013, we entered into a second limited waiver and limited consent agreement with MidCap, or Second Waiver. Under the Second Waiver, MidCap gave us its consent to waive certain provisions of the prior Credit Facility related to the maintenance of cash balances in the U.S. for past periods through December 31, 2013.

The Credit Facility includes traditional lending and reporting covenants which among other things requires us to maintain a fixed charge coverage ratio and a senior leverage ratio. The Credit Facility also includes several potential events of default, such as payment default and insolvency conditions, which could cause interest to be charged at a rate which is up to five percentage points above the rate effective immediately before the event of default or result in MidCap's right to declare all outstanding obligation immediately due and payable. We were in compliance with all of the covenants of the Credit Facility as of December 31, 2013.

We have various capital lease arrangements. The leases bear interest at rates ranging from 6.6% to 9.6%, are generally due in monthly principal and interest installments, are collateralized by the related equipment, and have various maturity dates through 2017. As of December 31, 2013, the balance of these capital leases, net of interest totaled \$1.3 million. There were no new leases in 2013.

On March 17, 2014, we entered into a First Amendment to Amended and Restated Credit, Security and Guaranty Agreement, or the First Amendment, with MidCap as Administrative Agent and lender and other lenders from time to time a party thereto, or together with MidCap, the Lenders. The First Amendment permits, among other things, our execution of, and borrowing of loans, under the Facility Agreement and Alphatec Spine's granting of liens as security

therefore, and the consummation of a Litigation Satisfaction and the completion of certain conditions. The First Amendment also added a total leverage ratio financial covenant.

50

---

## Contractual obligations and commercial commitments

Total contractual obligations and commercial commitments as of December 31, 2013 are summarized in the following table (in thousands):

	Payment Due by Year						
	Total	2014	2015	2016	2017	2018	Thereafter
Credit Facility and term loan with MidCap	\$52,081	\$3,000	\$3,000	\$46,081	\$—	\$—	\$—
Interest expense	11,087	4,320	4,156	2,611	—	—	—
Note payable for software licenses	58	58	—	—	—	—	—
Note payable for insurance premiums	1,427	1,427	—	—	—	—	—
Capital lease obligations	1,501	527	467	425	82	—	—
Operating lease obligations	7,665	3,346	2,725	1,363	216	15	—
Litigation settlement obligations	64,833	22,600	7,400	4,400	4,400	4,400	21,633
Minimum purchase commitments	36,282	7,032	5,850	5,850	5,850	5,850	5,850
Guaranteed minimum royalty obligations	12,286	1,968	2,418	2,218	2,218	2,246	1,218
New product development milestones (1)	2,750	250	—	2,500	—	—	—
Total	\$189,970	\$44,528	\$26,016	\$65,448	\$12,766	\$12,511	\$28,701

This commitment represents payments in cash, and is subject to attaining certain development milestones such as (1) FDA approval, product design and functionality testing requirements, which we believe are reasonably likely to be achieved in 2014 through 2016.

## Real Property Leases

In February 2008, we entered into a sublease agreement, or the Sublease, for office, engineering, and research and development space in Carlsbad, California, or Building 1. The Sublease term commenced May 2008 and ends on January 31, 2016. We are obligated under the Sublease to pay base rent and certain operating costs and taxes for Building 1. Monthly base rent payable by us was approximately \$80,500 during the first year of the Sublease, increasing annually at a fixed annual rate of 2.5% to approximately \$93,500 per month in the final year of the Sublease. Our rent was abated for months one through seven of the Sublease. Under the Sublease, we were required to provide the sublessor with a security deposit in the amount of approximately \$93,500. The Sublease of Building 1 allowed us to consolidate all corporate, marketing, finance, administrative, and research and development activities into one building.

In March 2008, we entered into a lease agreement, or the Lease, for additional office, engineering, research and development and warehouse and distribution space in Carlsbad, California, or Building 2. The Lease term commenced on December 1, 2008 and ends on January 31, 2017. We are obligated under the Lease to pay base rent and certain operating costs and taxes for Building 2. The monthly base rent payable for Building 2 was approximately \$73,500 during the first year of the Lease, increasing annually at a fixed annual rate of 3.0% to approximately \$93,000 per month in the final year of the Lease. Our rent was abated for the months two through eight of the term of the Lease in the amount of \$38,480. Under the Lease, we were required to provide the lessor with a security deposit in the amount of \$293,200, consisting of cash and/or one or more letters of credit. Following our achievement of certain financial milestones, the lessor is obligated to return a portion of the security deposit to us. The lessor provided a tenant improvement allowance of \$1.1 million to assist with the configuration of the facility to meet our business needs. We consolidated all manufacturing, distribution and warehousing activities into Building 2 in April 2009.

## Off-Balance Sheet Arrangements

As of December 31, 2013, we did not have any off-balance sheet arrangements.

## Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the

U.S. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures. On an on-going basis, we evaluate our estimates and assumptions, including those related to revenue recognition, allowances for accounts receivable, inventories, goodwill and intangible assets,

stock-based compensation and income taxes. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions conditions.

We believe the following accounting policies to be critical to the judgments and estimates used in the preparation of our consolidated financial statements.

#### Revenue Recognition

We recognize revenue when all four of the following criteria are met: (i) persuasive evidence that an arrangement exists; (ii) delivery of the products and/or services has occurred; (iii) the selling price is fixed or determinable; and (iv) collectability is reasonably assured. In addition, we account for revenue under provisions which set forth guidelines for the timing of revenue recognition based upon factors such as passage of title, installation, payment and customer acceptance. Determination of criteria (iii) and (iv) are based on management's judgment regarding the fixed nature of the fee charged for products delivered and the collectability of those fees. Specifically, our revenue from sales of spinal and other surgical implants is recognized upon receipt of written acknowledgment that the product has been used in a surgical procedure or upon shipment to third-party customers who immediately accept title to such implant. Should changes in conditions cause management to determine these criteria are not met for certain future transactions, revenues recognized for any reporting period could be adversely impacted.

#### Deferred Revenues

Deferred revenues consist of products sold to distributors with payment terms greater than our customary business terms due to lack of credit history or because the distributor is operating in a new market in which we have no prior experience. We defer the recognition of revenue until payments become due or cash is received from these distributors.

#### Inventories

Inventories are stated at the lower of cost or market, with cost primarily determined under the first-in, first-out method. We review the components of inventory on a periodic basis for excess, obsolete and impaired inventory, and record a reserve for the identified items. We calculate an inventory reserve for estimated excess and obsolete inventory based upon historical turnover and assumptions about future demand for our products and market conditions. Our biologics product inventories are subject to demand fluctuations based on the availability and demand for alternative implant products. Our estimates and assumptions for excess and obsolete inventory are subject to uncertainty as we are a high growth company, and we are continually reviewing our existing products and introducing new products. Increases in the reserve for excess and obsolete inventory result in a corresponding increase to cost of revenues and establish a new cost basis for the inventory component.

#### Valuation of Goodwill and Intangible Assets

We assess the impairment of our goodwill and intangible assets annually in December or each quarter if business conditions change and an earlier impairment indicator arises. This assessment requires us to make assumptions and judgments regarding the carrying value of these assets. These assets are considered to be impaired if we determine that their carrying value may not be recoverable based upon our assessment of the following events or changes in circumstances:

- a determination that the carrying value of such assets cannot be recovered through undiscounted cash flows;
- loss of legal ownership or title to the assets;
- significant changes in our strategic business objectives and utilization of the assets; or
- the impact of significant negative industry or economic trends.

If the assets are considered to be impaired, the impairment we recognize is the amount by which the carrying value of the assets exceeds the fair value of the assets. In addition, we base the useful lives and the related amortization expense on our estimate of the useful life of the assets. Due to the numerous variables associated with our judgments and assumptions relating to the carrying value of our goodwill and intangible assets and the effects of changes in circumstances affecting these valuations, both the precision and reliability of the resulting estimates are subject to uncertainty, and as additional information becomes known, we may change our estimate, in which case the likelihood of a material change in our reported results would increase.

We estimated the fair value in step one of the goodwill impairment model based on a combination of the income approach which included discounted cash flows as well as the market approach that utilized our market information. The income approach fair value measurements are categorized within Level 3 of the fair value hierarchy. Our discounted cash flows



required management judgment with respect to forecasted sales, launch of new products, gross margin, selling, general and administrative expenses, capital expenditures and the selection and use of an appropriate discount rate and terminal rate. For purposes of calculating the discounted cash flows, we used estimated revenue growth rates averaging between 4% and 12% for the discrete forecast period. Cash flows beyond the discrete forecasts were estimated using a terminal value calculation, which incorporated historical and forecasted financial trends and considered long-term earnings growth rates for publicly traded peer companies. Future cash flows were then discounted to present value at a discount rate of 12%, and terminal value growth rates of 4%. Publicly available information regarding comparable market capitalization was also considered in assessing the reasonableness of our fair value. Our assessment resulted in a fair value that was greater than our carrying value at December 31, 2013. In accordance with the authoritative literature, the second step of the impairment test was not required to be performed and thus no impairment of goodwill was recorded as of December 31, 2013.

Significant management judgment is required in the forecast of future operating results that are used in our impairment analysis. The estimates we used are consistent with the plans and estimates that we use to manage our business. Significant assumptions utilized in our income approach model included the growth rate of sales for recently introduced products and the introduction of anticipated new products similar to our historical growth rates. Another important assumption involved in forecasted sales is the projected mix of higher margin U.S. based sales and lower margin non-U.S. based sales. Additionally, we have projected an improvement in our gross margin similar to our historical improvements in gross margins, as a result of forecasted mix in U.S. sales versus non-U.S. based sales and lower manufacturing cost per unit based on the increase in forecasted volume to absorb applied overhead over the next ten years. Although we believe our underlying assumptions supporting this assessment are reasonable, if our forecasted sales, mix of product sales, growth rates of recently introduced new products, timing of and growth rates of new product introductions, gross margin, selling, general and administrative expenses, or the discount rate vary from our forecasts, we could be exposed to material impairment charges in the future.

#### Stock-Based Compensation

We account for stock-based compensation under provisions which require that share-based payment transactions with employees be recognized in the financial statements based on their fair value and recognized as compensation expense over the vesting period. The amount of expense recognized during the period is affected by subjective assumptions, including: estimates of our future volatility, the expected term for our stock options, the number of options expected to ultimately vest, and the timing of vesting for our share-based awards.

We use a Black-Scholes-Merton option-pricing model to estimate the fair value of our stock option awards. The calculation of the fair value of the awards using the Black-Scholes-Merton option-pricing model is affected by our stock price on the date of grant as well as assumptions regarding the following:

Estimated volatility is a measure of the amount by which our stock price is expected to fluctuate each year during the expected life of the award. Our estimated volatility through December 31, 2013 was based on our actual historical volatility since our initial public offering in June 2006. An increase in the estimated volatility would result in an increase to our stock-based compensation expense.

The expected term represents the period of time that awards granted are expected to be outstanding. Our estimated expected term through December 31, 2013 was calculated using a weighted-average term based on historical exercise patterns and the term from option date to full exercise for the options granted within the specified date range. An increase in the expected term would result in an increase to our stock-based compensation expense.

The risk-free interest rate is based on the yield curve of a zero-coupon U.S. Treasury bond on the date the stock option award is granted with a maturity equal to the expected term of the stock option award. An increase in the risk-free interest rate would result in an increase to our stock-based compensation expense.

The assumed dividend yield is based on our expectation of not paying dividends in the foreseeable future.

We use historical data to estimate the number of future stock option forfeitures. Share-based compensation recorded in our consolidated statement of operations is based on awards expected to ultimately vest and has been reduced for estimated forfeitures. Our estimated forfeiture rates may differ from our actual forfeitures which would affect the amount of expense recognized during the period.

We account for stock option grants to non-employees under provisions which require that the fair value of these instruments be recognized as an expense over the period in which the related services are rendered. Share-based compensation expense of awards with performance conditions is recognized over the period from the date the performance condition is determined to be probable of occurring through the time the applicable condition is met. Determining the likelihood and timing of achieving performance conditions is a subjective judgment made by management which may affect the amount and timing of expense related to these share-based awards. Share-based compensation is adjusted

to reflect the value of options which ultimately vest as such amounts become known in future periods. As a result of these subjective and forward-looking estimates, the actual value of our share-based awards could differ significantly from those amounts recorded in our financial statements.

Stock-based compensation has been classified as follows in the accompanying consolidated statements of operations (in thousands, except per share data):

	Year Ended December 31,			
	2013	2012	2011	
Cost of revenues	\$228	\$137	\$180	
Research and development	719	261	289	
Sales and marketing	459	1,695	693	
General and administrative	2,672	1,447	1,263	
Total	\$4,078	\$3,540	\$2,425	
Effect on basic and diluted net loss per share	\$(0.04)	) \$(0.04	) \$(0.03	)
Income Taxes				

We account for income taxes in accordance with provisions which set forth an asset and liability approach that requires the recognition of deferred tax assets and deferred tax liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities. Valuation allowances are established when necessary to reduce deferred tax assets to the amount that is more likely than not expected to be realized. In making such a determination, a review of all available positive and negative evidence must be considered, including scheduled reversal of deferred tax liabilities, projected future taxable income, tax planning strategies, and recent financial performance.

We recognize interest and penalties related to uncertain tax positions as a component of the income tax provision.

#### Recent Accounting Pronouncements

In February 2013, the FASB issued guidance that requires a company to disaggregate the total change of each component of other comprehensive income either on the face of the income statement or as a separate disclosure in the notes. The new guidance became effective for our interim period ended March 31, 2013. We adopted this guidance and the adoption did not have an impact on its financial position, results of operations or cash flows.

In March 2013, the FASB issued guidance on a parent company's accounting for the cumulative translation adjustment upon derecognition of a subsidiary or group of assets within a foreign entity. This new guidance requires that the parent release any related cumulative translation adjustment into net income only if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets had resided. The amendments are effective for us beginning January 1, 2014. We do not anticipate any impact on our financial statements upon adoption.

In July 2013, the FASB issued guidance that requires an unrecognized tax benefit, or a portion of an unrecognized tax benefit, to be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, unless an exception applies. The amendments in this update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2013. We early adopted this guidance for the period ended December 31, 2013, which is reflected in our consolidated financial statements as of and for the period ended December 31, 2013. There was no material impact on our financial statements upon adoption.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk

Our borrowings under our line of credit expose us to market risk related to changes in interest rates. As of December 31, 2013, our outstanding floating rate indebtedness totaled \$52.1 million. The primary base interest rate is LIBOR. Assuming the outstanding balance on our floating rate indebtedness remains constant over a year, a 100 basis point increase in the interest rate would decrease pre-tax income and cash flow by approximately \$0.5 million. Other outstanding debt consists of fixed rate instruments, including notes payable and capital leases.

Foreign Currency Risk

Our foreign currency exposure continues to grow as we expand internationally. Our exposure to foreign currency transaction gains and losses is the result of certain net receivables due from our foreign subsidiaries and customers being denominated in currencies other than the U.S. dollar, primarily the Euro and Japanese Yen, in which our revenues and profits are denominated. Additionally, we have exposure of U.S dollar denominated debt of approximately \$6.3 million recorded on our Japanese Yen functional currency subsidiary and exposure of U.S. dollar denominated litigation settlement of \$46.0 million recorded on a Euro functional currency subsidiary. We do not currently engage in hedging or similar transactions to reduce these risks. Fluctuations in currency exchange rates could impact our results of operations, financial position, and cash flows.

Commodity Price Risk

We purchase raw materials that are processed from commodities, such as titanium and stainless steel. These purchases expose us to fluctuations in commodity prices. Given the historical volatility of certain commodity prices, this exposure can impact our product costs. However, because our raw material prices comprise a small portion of our cost of revenues, we have not experienced any material impact on our results of operations from changes in commodity prices. A 10 percent change in commodity prices would not have a material impact on our results of operations for the year ended December 31, 2013.

Item 8. Financial Statements and Supplementary Data

The consolidated financial statements and supplementary data required by this item are set forth at the pages indicated in Item 15.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed by us in the reports we file or submit pursuant to the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, we carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as such term is defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this Annual Report on Form 10-K. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were: (1) designed to ensure that material information relating to us is made known to our Chief Executive Officer and Chief Financial Officer by others within our company, particularly during the period in which this report was being prepared and (2) effective, in that they provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Exchange Act, is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms.

Management's Annual Report on Internal Control Over Financial Reporting

Our management, including our Chief Executive Officer and Chief Financial Officer, is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) under the Exchange Act).

Our management, including our Chief Executive Officer and Chief Financial Officer, assessed the effectiveness of our internal control over financial reporting as of December 31, 2013. Management based this assessment on criteria for effective internal control over financial reporting described in "Internal Control—Integrated Framework" (1992 framework) issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management concluded that our internal control over financial reporting was effective as of December 31, 2013.

Ernst and Young LLP, an independent registered public accounting firm, who audited the consolidated financial statements included in this Annual Report on Form 10-K, has also audited the effectiveness of our internal control over financial reporting as stated in its report appearing elsewhere in this Annual Report on Form 10-K.

Changes in Internal Control over Financial Reporting.

There were no changes in our internal controls over financial reporting identified in connection with our evaluation of such internal control that occurred during the quarter ended December 31, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of  
Alphatec Holdings, Inc.

We have audited Alphatec Holdings, Inc.'s internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework) (the COSO criteria). Alphatec Holdings, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Report of Management on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Alphatec Holdings, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Alphatec Holdings, Inc. as of December 31, 2013 and 2012, and the related consolidated statements of operations, comprehensive loss, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2013 of Alphatec Holdings, Inc. and our report dated March 20, 2014 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP  
San Diego, California  
March 20, 2014

Item 9B.  
Not applicable.

Other Information

58

---

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information required by Item 10 of this Annual Report on Form 10-K is incorporated by reference from the discussion responsive thereto under the captions “Management,” “Corporate Governance Matters,” “Compliance with Section 16(a) of the Securities Exchange Act of 1934,” and “Code of Conduct and Ethics” in our Proxy Statement for the 2014 Annual Meeting of Stockholders.

Item 11. Executive Compensation

The information required by Item 11 of this Annual Report on Form 10-K is incorporated by reference from the discussion responsive thereto under the captions “Executive Officer and Director Compensation,” “Compensation Discussion and Analysis,” “Compensation Committee Interlocks and Insider Participation,” “Compensation Committee Report,” and “Compensation Practices and Policies Relating to Risk Management” in our Proxy Statement for the 2014 Annual Meeting of Stockholders.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by Item 12 of this Annual Report on Form 10-K is incorporated by reference from the discussion responsive thereto under the captions “Security Ownership of Certain Beneficial Owners and Management” and “Equity Compensation Plan Information” in our Proxy Statement for the 2014 Annual Meeting of Stockholders.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by Item 13 of this Annual Report on Form 10-K is incorporated by reference from the discussion responsive thereto under the captions “Certain Relationships and Related Transactions,” “Management” and “Corporate Governance Matters” in our Proxy Statement for the 2014 Annual Meeting of Stockholders.

Item 14. Principal Accounting Fees and Services

The information required by Item 14 of this Annual Report on Form 10-K is incorporated by reference from the discussion responsive thereto under the caption “Independent Public Accountants” in our Proxy Statement for the 2014 Annual Meeting of Stockholders.



## PART IV

## Item 15. Exhibits, Financial Statement Schedules

Item 15 (a) The following documents are filed as part of this Annual Report on Form 10-K:

## (1) Financial Statements:

	Page
<u>Report of Independent Registered Public Accounting Firm</u>	<u>F-2</u>
<u>Consolidated Balance Sheets</u>	<u>F-3</u>
<u>Consolidated Statements of Operations</u>	<u>F-4</u>
<u>Consolidated Statements of Comprehensive Loss</u>	<u>F-5</u>
<u>Consolidated Statements of Stockholders' Equity</u>	<u>F-6</u>
<u>Consolidated Statements of Cash Flows</u>	<u>F-7</u>
<u>Notes to Consolidated Financial Statements</u>	<u>F-9</u>
(2) Financial Statement Schedules:	
<u>Schedule II—Valuation and Qualifying Accounts</u>	<u>F-38</u>

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

## Item 15(a)(3) Exhibits List

The following is a list of exhibits filed as part of this Annual Report on Form 10-K.

Exhibit Number	Exhibit Description	Filed with this Report	Incorporated by Reference herein from Form or Schedule	Filing Date	SEC File/Reg. Number
2.1	Acquisition Agreement, dated December 17, 2009, by and among the Company and certain shareholders of Scient'x Groupe S.A.S. and Scient'x S.A.		Form 8-K (Exhibit 2.1)	12/22/09	000-52024
2.2†	Asset Purchase Agreement, dated October 19, 2012, between the Company and Phygen, LLC		Form 10-K (Exhibit 2.2)	03/05/12	000-52024
3.1	Restated Certificate of Incorporation		Amendment No. 2 to Form S-1 (Exhibit 3.2)	04/20/06	333-131609
3.2	Restated Bylaws		Amendment No. 5 to Form S-1 (Exhibit 3.4)	05/26/06	333-131609
4.1	Form of Common Stock Certificate	X			
4.2	Stockholders' Agreement by and among Alphatec Holdings, Inc., HealthpointCapital Partners, LP and certain investors, dated as of March 17, 2005		Amendment No. 4 to Form S-1 (Exhibit 4.2)	05/15/06	333-131609

4.3	Subscription Agreement dated as of June 4, 2009, between Alphatec Holdings, Inc. and HealthpointCapital Partners II, L.P.	Form 10-Q (Exhibit 10.2)	08/04/09	000-52024
-----	---	-----------------------------	----------	-----------

60

---

Edgar Filing: Alphatec Holdings, Inc. - Form 10-K

Exhibit Number	Exhibit Description	Filed with this Report	Incorporated by Reference herein from Form or Schedule	Filing Date	SEC File/Reg. Number
4.4	Corporate Governance Agreement, dated December 17, 2009, between the Company and certain shareholders of Scient'x Groupe S.A.S. and Scient'x S.A.		Form 8-K (Exhibit 10.1)	12/22/09	000-52024
4.5	Registration Rights Agreement, dated March 26, 2010, by and among Alphatec Holdings, Inc. and the other signatories thereto		Form 8-K (Exhibit 4.1)	03/31/10	000-52024
4.6	Form of Subscription Agreement, dated as of February 9, 2010, between the Company and each of the investors in the Offering		Form 8-K (Exhibit 10.1)	02/10/10	000-52024
4.7	Warrant with Silicon Valley Bank as the Warrantholder, dated December 16, 2011		Form 10-K (Exhibit 4.8)	03/05/12	000-52024
10.1	Lease Agreements Standard Industrial Lease (Net) by and between Alphatec Holdings, Inc. and H.G. Fenton Property Company, dated as of January 30, 2008		Form 10-Q (Exhibit 10.2)	05/12/08	000-52024
10.2	Sublease Agreement by and between Alphatec Holdings, Inc. and K2 Inc., dated as of February 28, 2008		Form 10-Q (Exhibit 10.1)	05/12/08	000-52024
10.3†	Loan Agreements Credit, Security and Guaranty Agreement by and among Alphatec Holdings, Inc., Alphatec Spine, Inc., Alphatec International, LLC, Alphatec Pacific, Inc. and MidCap Financial, LLC, dated June 6, 2012		Form 10-Q (Exhibit 10.1)	08/08/12	000-52024
Agreements with Respect to Collaborations, Licenses, Research and Development					
10.4†	License Agreement by and between Alphatec Spine, Inc. and Cross Medical Products, Inc., dated as of April 24, 2003		Amendment No. 1 to Form S-1 (Exhibit 10.26)	03/23/06	333-131609
10.5†	Supply Agreement by and between Alphatec Spine, Inc. and Invibio, Inc., dated as of October 18, 2004 and amended by Letter of Amendment in respect of the Supply		Amendment No. 4 to Form S-1 (Exhibit 10.29)	05/15/06	333-131609

Edgar Filing: Alphatec Holdings, Inc. - Form 10-K

Agreement, dated as of December 13, 2004

10.6†	Exclusive License Agreement by and between Alphatec Spine, Inc. and Stout Medical Group, LP, dated as of September 11, 2007	Form 10-Q (Exhibit 10.2)	11/09/07	000-52024
10.7†	First Amendment to the Exclusive License Agreement, effective March 31, 2009 between Alphatec Spine, Inc. and Stout Medical Group LP	Form 10-Q (Exhibit 10.4)	05/05/09	000-52024
10.8†	Exclusive License Agreement by and among Alphatec Spine, Inc., Alphatec Holdings, Inc. and Progressive Spinal Technologies LLC, dated as of December 18, 2007	Form 10-K (Exhibit 10.29)	03/17/08	000-52024

Edgar Filing: Alphatec Holdings, Inc. - Form 10-K

Exhibit Number	Exhibit Description	Filed with this Report	Incorporated by Reference herein from Form or Schedule	Filing Date	SEC File/Reg. Number
10.9†	Amendment to Exclusive License Agreement by and among Alphatec Spine, Inc., Alphatec Holdings, Inc. and Progressive Spinal Technologies LLC, dated as of January 14, 2008		Form 10-K/A (Exhibit 10.22)	07/07/09	000-52024
10.10†	Second Amendment to Exclusive License Agreement by and among Alphatec Spine, Inc., Alphatec Holdings, Inc. and Progressive Spinal Technologies LLC, dated as of January 12, 2009		Form 10-K/A (Exhibit 10.23)	07/07/09	000-52024
10.11†	Third Amendment to Exclusive License Agreement dated as of June 30, 2009, by and among Alphatec Holdings, Inc., Alphatec Spine, Inc. and Progressive Spinal Technologies LLC		Form 10-Q (Exhibit 10.3)	08/04/09	000-52024
10.12†	Fourth Amendment to Exclusive License Agreement dated as of December 7, 2009, by and among Alphatec Holdings, Inc., Alphatec Spine, Inc. and Progressive Spinal Technologies LLC		Form 10-K/A (Exhibit 10.38)	04/08/10	000-52024
10.13†	Fifth Amendment to Exclusive License Agreement dated as of November 30, 2010, by and among Alphatec Holdings, Inc., Alphatec Spine, Inc. and Progressive Spinal Technologies LLC		Form 10-K (Exhibit 10.22)	03/04/11	000-52024
10.14†	Cross License Agreement effective June 30, 2009, by and among Alphatec Holdings, Inc., Alphatec Spine, Inc. and International Spinal Innovations, LLC		Form 10-Q (Exhibit 10.1)	08/04/09	000-52024
10.15†	Letter Amendment between Alphatec Spine, Inc. and Invibio, Inc., dated November 24, 2010		Form 10-Q (Exhibit 10.3)	05/06/11	000-52024
10.16†	Settlement Agreement and General Release by and among Alphatec Spine, Inc., Cross Medical Products, LLC, and EBI, LLC, dated December 30, 2011		Form 10-K (Exhibit 10.27)	03/05/12	000-52024

Edgar Filing: Alphatec Holdings, Inc. - Form 10-K

10.17†	Amended License Agreement between Alphatec Spine, Inc. and Cross Medical Products, LLC, dated December 30, 2011	Form 10-K (Exhibit 10.28)	03/05/12	000-52024
10.18†	Employment Agreement by and among Alphatec Spine, Inc., Alphatec Holdings, Inc. and Michael O'Neill, dated October 11, 2010	Form 10-Q (Exhibit 10.2)	11/08/10	000-52024
10.19†	Employment Agreement, dated February 26, 2012, by and among Alphatec Holdings, Inc., Alphatec Spine, Inc. and Leslie Cross	Form 10-Q (Exhibit 10.1)	05/08/12	000-52024
10.20†	Amended and Restated Employment Agreement by and between Alphatec Spine, Inc. and Mitsuo Asai, dated January 14, 2011	Form 10-K (Exhibit 10.31)	03/04/11	000-52024
10.21†	Amended and Restated Employment Agreement by and among Alphatec Holdings, Inc., Alphatec Spine, Inc. and Ebun S. Garner, Esq., dated July 17, 2006	Form 10-K (Exhibit 10.20)	03/07/08	000-52024
10.22†	Non-Executive Chairman Consulting Agreement by and among Alphatec Spine, Inc., Alphatec Holdings, Inc. and Leslie Cross dated July 27, 2011	Form 10-Q (Exhibit 10.1)	11/04/11	000-52024

Edgar Filing: Alphatec Holdings, Inc. - Form 10-K

Exhibit Number	Exhibit Description	Filed with this Report	Incorporated by Reference herein from Form or Schedule	Filing Date	SEC File/Reg. Number
10.23†	Form of Indemnification Agreement entered into with each of the Company's non-employee directors		Form 10-Q (Exhibit 10.5)	05/05/09	000-52024
10.24†	Retention Bonus Agreement by and between Alphatec Holdings, Inc. and Steven Lubisher, dated August 24, 2012		Form 10-Q (Exhibit 10.2)	11/06/12	000-52024
10.25†	Retention Bonus Agreement by and between Alphatec Holdings, Inc. and Mitsuo Asai, dated August 21, 2012		Form 10-Q (Exhibit 10.3)	11/06/12	000-52024
10.26**	Collaboration Agreement by and among Alphatec Spine, Inc., Elite Medical Holdings, LLC and Pac 3 Surgical Products, LLC, dated as of October 22, 2013	X			
10.27**	Sixth Amendment to License Agreement by and between Alphatec Spine, Inc. and Progressive Spinal Technologies LLC, dated as of December 12, 2013	X			
10.28*	Equity Compensation Plans Amended and Restated 2005 Employee, Director and Consultant Stock Plan		Form S-8 (Exhibit 99.1)	12/20/13	333-187190
10.29*	Form of Non-Qualified Stock Option Agreement issued under the Amended and Restated 2005 Stock Plan		Form 10-K (Exhibit 10.40)	03/05/13	000-52024
10.30*	Form of Incentive Stock Option Agreement issued under the Amended and Restated 2005 Stock Plan		Form 10-K (Exhibit 10.41)	03/05/13	000-52024
10.31*	Form of Restricted Stock Agreement issued under the Amended and Restated 2005 Stock Plan		Form 10-K (Exhibit 10.42)	03/05/13	000-52024
10.32*	Amendment to the Amended and Restated 2005 Employee, Director and Consultant Stock Plan		Schedule 14A (Appendix B)	06/11/13	000-52024
10.33*	Amended 2007 Employee Stock Purchase Plan		Schedule 14A (Appendix C)	06/11/13	000-52024

Edgar Filing: Alphatec Holdings, Inc. - Form 10-K

10.34*	Summary Description of the Alphatec Holdings, Inc. 2013 Bonus Plan		Form 10-Q (Exhibit 10.3)	08/07/13	000-52024
21.1	List of subsidiaries of the Registrant	X			
23.1	Consent of Independent Registered Public Accounting Firm	X			
31.1	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X			
31.2	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X			



Edgar Filing: Alphatec Holdings, Inc. - Form 10-K

Exhibit Number	Exhibit Description	Filed with this Report	Incorporated by Reference herein from Form or Schedule	Filing Date	SEC File/Reg. Number
32	Certification pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X			
101.1	XBRL Instance Document**				
101.2	XBRL Taxonomy Extension Schema Document**				
101.3	XBRL Taxonomy Extension Calculation Linkbase Document**				
101.4	XBRL Taxonomy Extension Definition Linkbase Document**				
101.5	XBRL Taxonomy Extension Label Linkbase Document**				
101.6	XBRL Taxonomy Extension Presentation Linkbase Document**				

(\*) Management contract or compensatory plan or arrangement.

(†) Confidential treatment has been granted by the Securities and Exchange Commission as to certain portions.

(\*\*) Confidential treatment is being requested as to certain portions of this exhibit.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

ALPHATEC HOLDINGS, INC.

Dated: March 20, 2014

By: /S/ LESLIE H. CROSS  
 Name: Leslie H. Cross  
 Title: Chairman and Chief Executive Officer  
 (principal executive officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

Signature	Title	Date
/S/ LESLIE H. CROSS Leslie H. Cross	Chairman and Chief Executive Officer (principal executive officer)	March 20, 2014
/S/ MORTIMER BERKOWITZ III Mortimer Berkowitz III	Chairman of the Executive Committee of the Board of Directors	March 20, 2014
/S/ MICHAEL O'NEILL Michael O'Neill	Chief Financial Officer, Vice President and Treasurer (principal financial officer and principal accounting officer)	March 20, 2014
/S/ ROHIT DESAI Rohit Desai	Director	March 20, 2014
/S/ LUKE T. FAULSTICK Luke T. Faulstick	Director	March 20, 2014
/S/ JOHN H. FOSTER John H. Foster	Director	March 20, 2014
/S/ JAMES R. GLYNN James R. Glynn	Director	March 20, 2014
/S/ SIRI S. MARSHALL Siri S. Marshall	Director	March 20, 2014
/S/ R. IAN MOLSON R. Ian Molson	Director	March 20, 2014
/S/ STEPHEN E. O'NEIL Stephen E. O'Neil	Director	March 20, 2014



ALPHATEC HOLDINGS, INC.  
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

	Page
<u>Report of Independent Registered Public Accounting Firm</u>	<u>F-2</u>
<u>Consolidated Balance Sheets</u>	<u>F-3</u>
<u>Consolidated Statements of Operations</u>	<u>F-4</u>
<u>Consolidated Statements of Comprehensive Loss</u>	<u>F-5</u>
<u>Consolidated Statements of Stockholders' Equity</u>	<u>F-6</u>
<u>Consolidated Statements of Cash Flows</u>	<u>F-7</u>
<u>Notes to Consolidated Financial Statements</u>	<u>F-9</u>

F-1

---

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of  
Alphatec Holdings, Inc.

We have audited the accompanying consolidated balance sheets of Alphatec Holdings, Inc. as of December 31, 2013 and 2012, and the related consolidated statements of operations, comprehensive loss, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2013. Our audits also included the financial statement schedule listed in the Index at Item 15(a)(2). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Alphatec Holdings, Inc., at December 31, 2013 and 2012, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2013, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Alphatec Holdings, Inc.'s internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework) and our report dated March 20, 2014 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP  
San Diego, California  
March 20, 2014

ALPHATEC HOLDINGS, INC.  
CONSOLIDATED BALANCE SHEETS  
(In thousands, except par value data)

	December 31, 2013	2012
Assets		
Current assets:		
Cash	\$21,345	\$22,241
Accounts receivable, net	41,395	41,012
Inventories, net	41,939	49,855
Prepaid expenses and other current assets	7,694	5,953
Deferred income tax assets	1,372	2,991
Total current assets	113,745	122,052
Property and equipment, net	28,030	30,403
Goodwill	183,004	180,838
Intangibles, net	39,064	46,856
Other assets	1,787	1,978
Total assets	\$365,630	\$382,127
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$10,790	\$15,237
Accrued expenses	62,996	38,490
Deferred revenue	1,009	1,361
Current portion of long-term debt	4,924	1,700
Total current liabilities	79,719	56,788
Long-term debt, less current portion	49,978	39,967
Other long-term liabilities	38,784	13,485
Deferred income tax liabilities	1,870	2,468
Commitments and contingencies		
Redeemable preferred stock, \$0.0001 par value; 20,000 authorized at December 31, 2013 and 2012; 3,319 shares issued and outstanding at both December 31, 2013 and 2012	23,603	23,603
Stockholders' equity:		
Common stock, \$0.0001 par value; 200,000 authorized; 97,599 and 96,703 shares issued and outstanding at December 31, 2013 and 2012, respectively	10	10
Treasury stock, 19 shares	(97	) (97
Additional paid-in capital	403,568	399,246
Accumulated other comprehensive income (loss)	3,877	112
Accumulated deficit	(235,682	) (153,455
Total stockholders' equity	171,676	245,816
Total liabilities and stockholders' equity	\$365,630	\$382,127
See accompanying notes.		

ALPHATEC HOLDINGS, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(In thousands, except per share amounts)

	Year Ended December 31,			
	2013	2012	2011	
Revenues	\$204,724	\$196,278	\$197,711	
Cost of revenues	78,669	70,761	79,168	
Amortization of acquired intangible assets	1,733	1,749	1,613	
Gross profit	124,322	123,768	116,930	
Operating expenses:				
Research and development	14,190	14,886	16,888	
In-process research and development	—	341	—	
Sales and marketing	76,960	75,177	75,189	
General and administrative	47,949	39,939	36,367	
Amortization of acquired intangible assets	3,009	2,180	2,152	
Transaction related expenses	—	1,082	—	
Restructuring expenses	9,665	—	1,050	
Litigation settlement expenses	45,982	—	9,800	
Total operating expenses	197,755	133,605	141,446	
Operating loss	(73,433	) (9,837	) (24,516	)
Other income (expense):				
Interest income	6	118	148	
Interest expense	(3,959	) (6,105	) (3,027	)
Other income (expense), net	(1,662	) (794	) 707	)
Total other income (expense)	(5,615	) (6,781	) (2,172	)
Pretax net loss	(79,048	) (16,618	) (26,688	)
Income tax provision (benefit)	3,179	(1,159	) (4,507	)
Net loss	\$(82,227	) \$(15,459	) \$(22,181	)
Net loss per common share:				
Basic and diluted	\$(0.85	) \$(0.17	) \$(0.25	)
Weighted-average shares used in computing net loss per share:				
Basic and diluted	96,235	90,218	88,798	
See accompanying notes.				

ALPHATEC HOLDINGS, INC.  
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS  
 (in thousands)

	Year Ended December 31,		
	2013	2012	2011
Net loss	\$ (82,227	) \$ (15,459	) \$ (22,181
Foreign currency translation adjustments	3,765	2,924	(1,502
Comprehensive loss	\$ (78,462	) \$ (12,535	) \$ (23,683
See accompanying notes.			

F-5

---



ALPHATEC HOLDINGS, INC.  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
(In thousands)

	Common stock		Additional paid-in capital	Treasury stock	Accumulated other comprehensive income (loss)	Accumulated deficit	Total stockholders' equity
	Shares	Amount					
Balance at December 31, 2010	89,040	\$ 9	\$ 383,647	\$ (97 )	\$ (1,310 )	\$ (115,815 )	\$ 266,434
Stock-based compensation	—	—	2,525	—	—	—	2,525
Exercise of stock options	55	—	104	—	—	—	104
Repurchase and/or forfeiture of common stock	(67 )	—	(193 )	—	—	—	(193 )
Mark-to-market for third party restricted stock	—	—	(100 )	—	—	—	(100 )
Issuance of warrants in connection with credit facility	—	—	99	—	—	—	99
Issuance of common stock for employee stock purchase plan	63	—	142	—	—	—	142
Issuance of common stock for restricted share awards granted to employees	271	—	—	—	—	—	—
Foreign currency translation adjustments	—	—	—	—	(1,502 )	—	(1,502 )
Net loss	—	—	—	—	—	(22,181 )	(22,181 )
Balance at December 31, 2011	89,362	9	386,224	(97 )	(2,812 )	(137,996 )	245,328
Stock-based compensation	—	—	2,406	—	—	—	2,406
Exercise of stock options	62	—	76	—	—	—	76
Repurchase and/or forfeiture of common stock	(115 )	—	(49 )	—	—	—	(49 )
Shares issued for consulting services	938	—	1,284	—	—	—	1,284
Issuance of common stock in connection with license agreements	139	—	250	—	—	—	250
Issuance of common stock in connection with Phygen acquisition	5,240	1	8,855	—	—	—	8,856
Issuance of common stock for equity offering	231	—	—	—	—	—	—
Issuance of common stock for employee stock purchase plan	145	—	200	—	—	—	200
Issuance of common stock for restricted share awards granted to employees	701	—	—	—	—	—	—
Foreign currency translation adjustments	—	—	—	—	2,924	—	2,924
Net loss	—	—	—	—	—	(15,459 )	(15,459 )
Balance at December 31, 2012	96,703	10	399,246	(97 )	112	(153,455 )	245,816
Stock-based compensation	—	—	2,590	—	—	—	2,590
Exercise of stock options	6	—	8	—	—	—	8
	(142 )	—	(172 )	—	—	—	(172 )

Edgar Filing: Alphatec Holdings, Inc. - Form 10-K

Repurchase and/or forfeiture of common stock							
Shares issued for consulting services	354	—	1,488	—	—	—	1,488
Issuance of common stock in connection with license agreements	130	—	250	—	—	—	250
Forfeiture of common stock in connection with Phygen acquisition	(328 )	—	(561 )	—	—	—	(561 )
Issuance of common stock for employee stock purchase plan	500	—	719	—	—	—	719
Issuance of common stock for restricted share awards granted to employees	376	—	—	—	—	—	—
Foreign currency translation adjustments	—	—	—	—	3,765	—	3,765
Net loss	—	—	—	—	—	(82,227 )	(82,227 )
Balance at December 31, 2013	97,599	\$ 10	\$403,568	\$ (97 )	\$ 3,877	\$ (235,682 )	\$ 171,676

See accompanying notes.

F-6

---

ALPHATEC HOLDINGS, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In thousands)

	Year Ended December 31,		
	2013	2012	2011
Operating activities:			
Net loss	\$(82,227	) \$(15,459	) \$(22,181
Adjustments to reconcile net loss to net cash provided by operating activities:			
Depreciation and amortization	26,277	23,792	19,876
Stock-based compensation	4,078	3,690	2,425
Interest expense related to amortization of debt discount and debt issuance costs	368	919	375
In-process research and development	—	341	—
Provision for doubtful accounts	404	859	1,094
Provision for excess and obsolete inventory	11,652	6,658	4,564
Litigation settlement	—	—	9,800
Deferred income tax provision (benefit)	816	(3,420	) (4,345
Other non-cash items	1,464	2,158	—
Changes in operating assets and liabilities:			
Accounts receivable	(1,940	) 382	(5,004
Inventories	(4,407	) (7,853	) 1,084
Prepaid expenses and other current assets	450	1,681	1,341
Other assets	64	992	1,216
Accounts payable	(3,853	) (1,799	) 2,545
Accrued expenses and other	55,171	(1,764	) 1,246
Deferred revenue	(510	) 416	(628
Net cash provided by operating activities	7,807	11,593	13,408
Investing activities:			
Purchases of property and equipment	(14,352	) (15,646	) (8,206
Purchase of intangible assets	(750	) (1,750	) (690
Cash paid for acquisitions	(4,000	) (2,000	) (620
Net cash used in investing activities	(19,102	) (19,396	) (9,516
Financing activities:			
Exercise of stock options	8	76	104
Borrowings under lines of credit	154,622	121,232	2,350
Repayments under lines of credit	(168,855	) (99,853	) (17,346
Principal payments on capital lease obligations	(434	) (604	) (143
Proceeds from issuance of notes payable	28,000	—	10,000
Principal payments on notes payable	(2,654	) (12,375	) (1,880
Net cash provided by (used in) financing activities	10,687	8,476	(6,915
Effect of exchange rate changes on cash	(288	) 902	521
Net increase (decrease) in cash	(896	) 1,575	(2,502
Cash at beginning of period	22,241	20,666	23,168
Cash at end of period	\$21,345	\$22,241	\$20,666

See accompanying notes.

F-7

---

ALPHATEC HOLDINGS, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS—(Continued)  
(in thousands)

	Year Ended December 31,		
	2013	2012	2011
Supplemental disclosure of cash flow information:			
Cash paid for interest	\$3,973	\$2,592	\$2,322
Cash paid for income taxes	\$1,780	\$989	\$523
Purchases of property and equipment in accounts payable	\$1,513	\$1,367	\$3,242
Purchase of property and equipment through capital leases	\$—	\$2,225	\$—
Non-cash purchases of license agreements	\$250	\$1,000	\$8,000
Issuance of common stock in connection with acquisitions	\$—	\$8,856	\$—
See accompanying notes.			

F-8

---

ALPHATEC HOLDINGS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. The Company and Basis of Presentation

The Company

Alphatec Holdings, Inc. (“Alphatec”, “Alphatec Holdings” or the “Company”), through its wholly owned subsidiary, Alphatec Spine, Inc. and its subsidiaries (“Alphatec Spine”) designs, develops, manufactures and markets products for the surgical treatment of spine disorders, primarily focused on the aging spine. In addition to its U.S. operations, the Company also markets its products in over 50 international markets through its affiliate, Scient’x S.A.S. and its subsidiaries (“Scient’x”), via a direct salesforce in France, Italy and the United Kingdom and via independent distributors in the rest of Europe, the Middle East and Africa. In South America and Latin America the Company conducts its operations through its Brazilian subsidiary, Cibramed Productos Medicos. In Asia, the Company markets its products through its subsidiary, Alphatec Pacific, Inc. and its subsidiaries (“Alphatec Pacific”) via a direct sales force and independent distributors, and through distributors in other parts of Asia and Australia.

Basis of Presentation

The consolidated financial statements include the accounts of Alphatec and Alphatec Spine and its wholly owned subsidiaries. All intercompany balances and transactions have been eliminated in the consolidated financial statements.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. A going concern basis of accounting contemplates the recovery of the Company’s assets and the satisfaction of its liabilities in the normal course of business. Based on the Company’s annual operating plan, management believes that its existing cash of \$21 million combined with anticipated cash flow from operations in 2014 and other working capital of \$13 million at December 31, 2013 and the Company's available borrowings under credit facilities with MidCap Financial, LLC (“MidCap”) and Deerfield (defined in Note 17) will be sufficient to fund its operating cash requirements, including the required payments due under the Orthotec Litigation Settlement (Note 17), through at least December 31, 2014.

The Company’s credit facility (the “Credit Facility”) with MidCap contains financial covenants consisting of a monthly fixed charge coverage ratio, a senior leverage ratio and a total leverage ratio (see Note 6 and Note 17). Based on the Company’s board-approved current operating plan, the Company believes that it will be in compliance with the financial covenants of the Credit Facility at least through December 31, 2014. However, there is no assurance that the Company will be able to do so. If the Company is not able to achieve its planned revenue or incurs costs in excess of its forecasts, it may be required to substantially reduce discretionary spending and it could be in default of the Credit Facility which would require a waiver from MidCap. There can be no assurance that such a waiver could be obtained, that the Credit Facility could be successfully renegotiated or that the Company can modify its operations to maintain liquidity. If the Company is unable to obtain any required waivers or amendments, MidCap would have the right to exercise remedies specified in the Credit Facility, including accelerating the repayment of debt obligations. The Company may be forced to seek additional financing, which may include additional debt and/or equity financing or funding through other third party agreements. There can be no assurances that additional financing will be available on acceptable terms or available at all. Furthermore, any equity financing may result in dilution to existing stockholders and any debt financing may include restrictive covenants.

2. Summary of Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts in the Company’s consolidated financial statements and accompanying notes. Actual results could differ from those estimates.



ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Concentrations of Credit Risk and Significant Customers

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist primarily of cash and accounts receivable. The Company limits its exposure to credit loss by depositing its cash and cash equivalents with established financial institutions. As of December 31, 2013 a substantial portion of the Company's available cash funds is in business accounts. Although the Company deposits its cash and cash equivalents with multiple financial institutions, its deposits, at times, may exceed federally insured limits.

The Company's customers are primarily hospitals, surgical centers and distributors and no single customer represented greater than 10 percent of consolidated revenues for any of the periods presented. Credit to customers is granted based on an analysis of the customers' credit worthiness and credit losses have not been significant.

Revenue Recognition

The Company derives its revenues primarily from the sale of spinal surgery implants used in the treatment of spine disorders. The Company sells its products primarily through its direct sales force and independent distributors.

Revenue is recognized when all four of the following criteria are met: (i) persuasive evidence of an arrangement exists; (ii) delivery of the products and/or services has occurred; (iii) the selling price is fixed or determinable; and (iv) collectability is reasonably assured. In addition, the Company accounts for revenue under provisions which sets forth guidelines for the timing of revenue recognition based upon factors such as passage of title, installation, payment and customer acceptance.

The Company's revenue from sales of spinal and other surgical implants is recognized upon receipt of written acknowledgement that the product has been used in a surgical procedure or upon shipment to third-party customers who immediately accept title to such implant.

Deferred revenues consist of products sold to distributors with payment terms greater than the Company's customary business terms due to lack of credit history or because the distributor is operating in a new market in which the Company has no prior experience. The Company defers the recognition of revenue until payments become due and cash is received from these distributors. As of December 31, 2013 and 2012, the balance in deferred revenue totaled \$1.0 million and \$1.4 million, respectively.

Accounts Receivable

Accounts receivable are presented net of allowance for doubtful accounts. The Company makes judgments as to its ability to collect outstanding receivables and provides allowances for a portion of receivables when collection becomes doubtful. Provisions are made based upon a specific review of all significant outstanding invoices and the overall quality and age of those invoices not specifically reviewed. In determining the provision for invoices not specifically reviewed, the Company analyzes historical collection experience. If the historical data used to calculate the allowance provided for doubtful accounts does not reflect the Company's future ability to collect outstanding receivables or if the financial condition of customers were to deteriorate, resulting in impairment of their ability to make payments, an increase in the provision for doubtful accounts may be required.

Inventories

Inventories are stated at the lower of cost or market, with cost primarily determined under the first-in, first-out method. The Company reviews the components of inventory on a periodic basis for excess, obsolete and impaired inventory, and records a reserve for the identified items. The Company calculates an inventory reserve for estimated excess and obsolete inventory based upon historical turnover and assumptions about future demand for its products and market conditions. The Company's biologics inventories have an expiration based on shelf life and are subject to demand fluctuations based on the availability and demand for alternative implant products. The Company's estimates and assumptions for excess and obsolete inventory are reviewed and updated on a quarterly basis. Increases in the reserve for excess and obsolete inventory result in a corresponding increase to cost of revenues and establish a new cost basis for the part. Approximately \$18.4 million and \$22.0 million of inventory was held at consigned locations as



of December 31, 2013 and 2012, respectively.

**Property and Equipment**

Property and equipment are stated at cost, net of accumulated depreciation and amortization. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets, generally ranging from three to seven years. Leasehold improvements and assets acquired under capital leases are amortized over the shorter of their useful lives or the terms of the related leases.

F-10

---

## ALPHATEC HOLDINGS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## Goodwill and Other Intangible Assets

The Company accounts for goodwill and other intangible assets in accordance with provisions which require that goodwill and other identifiable intangible assets with indefinite useful lives be tested for impairment at least annually. The Company tests goodwill and intangible assets for impairment in December of each year, or more frequently if events and circumstances warrant. These assets are impaired if the Company determines that their carrying values may not be recoverable based on an assessment of certain events or changes in circumstances. If the assets are considered to be impaired, the Company recognizes the amount by which the carrying value of the assets exceeds the fair value of the assets as an impairment loss. During the year ended December 31, 2013, the Company decided that it would not continue to market an adult stem cell product sold under the Company's private label name of Puregen. The Company also decided that it would no longer actively market two additional products. The Company expensed \$1.3 million as impairment charges in cost of goods sold in the year ended December 31, 2013 for the write-off of intangible assets related to these products.

The Company estimated the fair value in step one of the goodwill impairment test based on a combination of the income approach which included discounted cash flows as well as a market approach that utilized the Company's market information. The income approach fair value measurements are categorized within Level 3 of the fair value hierarchy. The Company's discounted cash flows required management judgment with respect to forecasted sales, launch of new products, gross margin, selling, general and administrative expenses, capital expenditures and the selection and use of an appropriate discount rate and terminal rate. For purposes of calculating the discounted cash flows, the Company used estimated revenue growth rates averaging between 4% and 12% for the discrete forecast period. Cash flows beyond the discrete forecasts were estimated using a terminal value calculation, which incorporated historical and forecasted financial trends and considered long-term earnings growth rates for publicly traded peer companies. Future cash flows were then discounted to present value at a discount rate of 12%, and terminal value growth rate of 4%. Publicly available information regarding comparable market capitalization was also considered in assessing the reasonableness of the Company's fair value. The Company's assessment resulted in a fair value that was greater than the Company's carrying value at December 31, 2013. In accordance with the authoritative literature, the second step of the impairment test was not required to be performed and thus no impairment of goodwill was recorded as of December 31, 2013.

Significant management judgment is required in the forecast of future operating results that are used in the Company's impairment analysis. The estimates the Company used are consistent with the plans and estimates that it uses to manage its business. Significant assumptions utilized in the Company's income approach model included the growth rate of sales for recently introduced products and the introduction of anticipated new products similar to its historical growth rates. Another important assumption involved in forecasted sales is the projected mix of higher margin U.S. based sales and lower margin non-U.S. based sales. Additionally, the Company has projected an improvement in its gross margin, similar to its historical improvement in gross margins, as a result of its forecasted mix in U.S. sales versus non-U.S. based sales and lower manufacturing cost per unit based on the increase in forecasted volume to absorb applied overhead over the next ten years. Although the Company believes its underlying assumptions supporting this assessment are reasonable, if the Company's forecasted sales, mix of product sales, growth rates of recently introduced new products, timing of and growth rates of new product introductions, gross margin, selling, general and administrative expenses, or the discount rate vary from its forecasts, the Company could be exposed to material impairment charges in the future. Additionally, if the Company's stock price decreases significantly from the closing price on December 31, 2013, the Company may be required to perform an interim analysis in 2014 that could result in an impairment charge.

The accounting provisions also require that intangible assets with definite useful lives be amortized over their respective estimated useful lives and reviewed for indicators of impairment. The Company is amortizing its intangible

assets, other than goodwill, on a straight-line basis over a one to fifteen-year period.

#### Impairment of Long-Lived Assets

The Company assesses potential impairment to its long-lived assets when there is evidence that events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment loss is recognized when the carrying amount of the long-lived assets is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. Any required impairment loss is measured as the amount by which the carrying amount of a long-lived asset exceeds its fair value and is recorded as a reduction in the carrying value of the related asset and a charge to operating results.

Due to the Scient'x restructuring plan, the Company assessed potential impairment on certain intangible assets related to the Scient'x acquisition. Based on this assessment the projected undiscounted cash flows exceeded the carrying amount of the intangible assets and no impairment loss was recognized in the year ended December 31, 2013.

F-11

---

ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Foreign Currency

The Company's results of operations and cash flows are subject to fluctuations due to changes in foreign currency exchange rates. The Company's primary functional currency is the U.S. dollar, while the functional currency of the Company's Japanese subsidiary is the Japanese Yen, the Hong Kong subsidiary is the Hong Kong dollar and the functional currency of the Company's European operations is the Euro. Assets and liabilities denominated in foreign currencies are translated at the rate of exchange on the balance sheet date. Revenues and expenses are translated using the average exchange rate for the period. Net gains and losses resulting from the translation of foreign financial statements are recorded as accumulated other comprehensive income (loss) in stockholders' equity. Net foreign currency gains or (losses) resulting from transactions in currencies other than the functional currencies are included in other income (expense), net in the accompanying consolidated statements of operations. For the years ended December 31, 2013, 2012 and 2011, the Company recorded net foreign currency gains (losses) of approximately \$(1.7) million, \$(0.9) million and \$0.5 million, respectively.

Fair Value of Financial Instruments

The carrying value of accounts receivable, foreign cash accounts, prepaid expenses, other current assets, accounts payable, accrued expenses, and current portion of debt are considered to be representative of their respective fair values because of the short-term nature of those instruments. Based on the borrowing rates currently available to the Company for loans with similar terms, management believes the fair value of notes payable, capital leases and other long-term debt approximates their carrying values.

The Company measures its fair value of financial instruments in accordance with the established framework for fair value using "levels" which are defined as follows: Level 1 fair value is determined from observable, quoted prices in active markets for identical assets or liabilities. Level 2 fair value is determined from quoted prices for similar items in active markets or quoted prices for identical or similar items in markets that are not active. Level 3 fair value is determined using the entity's own assumptions about the inputs that market participants would use in pricing an asset or liability.

The Company reassesses the fair value of contingent consideration of \$3.8 million to be settled in cash related to acquisitions on a quarterly basis using the present value of future royalty payments due. This is a Level 3 measurement. Significant assumptions used in the measurement include estimates of the royalty payments due.

Research and Development

Research and development expense consists of costs associated with the design, development, testing, and enhancement of the Company's products. Research and development costs also include salaries and related employee benefits, research-related overhead expenses, fees paid to external service providers, and costs associated with the Company's Scientific Advisory Board and Executive Surgeon Panels. Research and development costs are expensed as incurred.

In-Process Research and Development

In-process research and development ("IPR&D") consists of acquired research and development assets that are not part of an acquisition of a business and were not technologically feasible on the date the Company acquired them and had no alternative future use at that date or IPR&D assets acquired in a business acquisition that are determined to have no alternative future use. The Company expects all acquired IPR&D will reach technological feasibility, but there can be no assurance that commercial viability of these products will ever be achieved. The nature of the efforts to develop the acquired technologies into commercially viable products consists principally of planning, designing, developing and testing products in order to obtain regulatory approvals. If commercial viability were not achieved, the Company would likely look to other alternatives to provide these products. Until the technological feasibility of the acquired research and development assets are established, the Company expenses these costs.

Leases

The Company leases its facilities and certain equipment and vehicles under operating leases, and certain equipment under capital leases. For facility leases that contain rent escalation or rent concession provisions, the Company records the total rent payable during the lease term on a straight-line basis over the term of the lease. The Company records the difference between the rent paid and the straight-line rent as a deferred rent liability in the accompanying consolidated balance sheets.

F-12

---

## ALPHATEC HOLDINGS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## Product Shipment Cost

Product shipment costs are included in sales and marketing expense in the accompanying consolidated statements of operations. Product shipment costs totaled \$3.1 million, \$2.9 million and \$3.6 million for the years ended December 31, 2013, 2012 and 2011, respectively.

## Stock-Based Compensation

The Company accounts for stock-based compensation under provisions which require that share-based payment transactions with employees be recognized in the financial statements based on their fair value and recognized as compensation expense over the vesting period. The amount of expense recognized during the period is affected by subjective assumptions, including: estimates of the Company's future volatility, the expected term for its stock options, the number of options expected to ultimately vest, and the timing of vesting for the Company's share-based awards. The Company uses a Black-Scholes-Merton option-pricing model to estimate the fair value of its stock option awards. The calculation of the fair value of the awards using the Black-Scholes-Merton option-pricing model is affected by the Company's stock price on the date of grant as well as assumptions regarding the following:

Estimated volatility is a measure of the amount by which the Company's stock price is expected to fluctuate each year during the expected life of the award. The Company's estimated volatility through December 31, 2013 was based on a weighted-average volatility of its actual historical volatility over a period equal to the expected life of the awards.

The expected term represents the period of time that awards granted are expected to be outstanding. Through December 31, 2013, the Company calculated the expected term using a weighted-average term based on historical exercise patterns and the term from option date to full exercise for the options granted within the specified date range.

The risk-free interest rate is based on the yield curve of a zero-coupon U.S. Treasury bond on the date the stock option award is granted with a maturity equal to the expected term of the stock option award.

The assumed dividend yield is based on the Company's expectation of not paying dividends in the foreseeable future.

The Company used historical data to estimate the number of future stock option forfeitures. Share-based compensation recorded in the Company's consolidated statement of operations is based on awards expected to ultimately vest and has been reduced for estimated forfeitures. The Company's estimated forfeiture rates may differ from its actual forfeitures which would affect the amount of expense recognized during the period.

The Company values equity awards with a market condition using a Monte Carlo simulation model.

The Company accounts for stock option grants to non-employees in accordance with provisions which require that the fair value of these instruments be recognized as an expense over the period in which the related services are rendered. Share-based compensation expense of awards with performance conditions is recognized over the period from the date the performance condition is determined to be probable of occurring through the time the applicable condition is met. Determining the likelihood and timing of achieving performance conditions is a subjective judgment made by management which may affect the amount and timing of expense related to these share-based awards. Share-based compensation is adjusted to reflect the value of options which ultimately vest as such amounts become known in future periods.

## Valuation of Stock Option Awards

The assumptions used to compute the share-based compensation costs for the stock options granted during the years ended December 31, 2013, 2012 and 2011 are as follows:

	Year Ended December 31,		
	2013	2012	2011
Risk-free interest rate	1.1-1.8%	0.9-1.2%	1.2-2.5%
Expected dividend yield	—	—	—

Edgar Filing: Alphatec Holdings, Inc. - Form 10-K

Weighted average expected life (years)	5.3-5.5	5.3-5.8	5.8-5.9
Volatility	75-76%	75-78%	56-57%

F-13

---

## ALPHATEC HOLDINGS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## Compensation Costs

The compensation cost that has been included in the Company's consolidated statement of operations for all stock-based compensation arrangements is detailed as follows (in thousands, except per share amounts):

	Year Ended December 31,		
	2013	2012	2011
Cost of revenues	\$228	\$137	\$180
Research and development	719	261	289
Sales and marketing	459	1,695	693
General and administrative	2,672	1,447	1,263
Total	\$4,078	\$3,540	\$2,425

The amounts above include stock-based compensation expense of \$1.5 million, \$1.3 million and \$0 million during the years ended December 31, 2013, 2012 and 2011, respectively, related to the vesting of stock options and awards granted to non-employees under consulting agreements.

## Income Taxes

The Company accounts for income taxes in accordance with provisions which set forth an asset and liability approach that requires the recognition of deferred tax assets and deferred tax liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. In making such determination, a review of all available positive and negative evidence must be considered, including scheduled reversal of deferred tax liabilities, projected future taxable income, tax planning strategies, and recent financial performance.

The Company recognizes interest and penalties related to uncertain tax positions as a component of the income tax provision.

## Net Loss per Share

Basic earnings per share ("EPS") is calculated by dividing the net income or loss available to common stockholders by the weighted average number of common shares outstanding for the period, without consideration for common stock equivalents. Diluted EPS is computed by dividing the net income or loss available to common stockholders by the weighted average number of common shares outstanding for the period and the weighted average number of dilutive common stock equivalents outstanding for the period determined using the treasury-stock method. For purposes of this calculation, common stock subject to repurchase by the Company and options are considered to be common stock equivalents and are only included in the calculation of diluted earnings per share when their effect is dilutive. (In thousands, except per share data):

	Year Ended December 31,		
	2013	2012	2011
Numerator:			
Net loss	\$(82,227)	\$(15,459)	\$(22,181)
Denominator:			
Weighted average common shares outstanding	97,111	90,870	89,165
Weighted average unvested common shares subject to repurchase	(876)	(652)	(368)
Weighted average common shares outstanding—basic	96,235	90,218	88,797
Effect of dilutive securities:			
Options, warrants and restricted share awards	—	—	—



Edgar Filing: Alphatec Holdings, Inc. - Form 10-K

Weighted average common shares outstanding—diluted	96,235	90,218	88,797	
Net loss per common share:				
Basic and diluted net loss per share	\$(0.85	) \$(0.17	) \$(0.25	)

F-14

---

## ALPHATEC HOLDINGS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

As of December 31, 2013, 2012 and 2011, none of the outstanding redeemable preferred stock is convertible to common stock.

The weighted-average anti-dilutive securities not included in diluted net loss per share were as follows (in thousands):

	Year Ended December 31,		
	2013	2012	2011
Options to purchase common stock	4,597	4,621	4,323
Warrants to purchase common stock	594	594	94
Unvested restricted stock awards	807	877	368
	5,998	6,092	4,785

#### Recent Accounting Pronouncements

In February 2013, the FASB issued guidance that requires a company to disaggregate the total change of each component of other comprehensive income either on the face of the income statement or as a separate disclosure in the notes. The new guidance became effective for our interim period ended March 31, 2013. The Company adopted this guidance and the adoption did not have any impact on its financial position, results of operations or cash flows.

In March 2013, the FASB issued guidance on a parent company's accounting for the cumulative translation adjustment upon derecognition of a subsidiary or group of assets within a foreign entity. This new guidance requires that the parent release any related cumulative translation adjustment into net income only if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets had resided. The amendments are effective for the Company beginning January 1, 2014. The Company does not anticipate any impact on its financial statements upon adoption.

In July 2013, the FASB issued guidance that requires an unrecognized tax benefit, or a portion of an unrecognized tax benefit to be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, unless an exception applies. The Company early adopted this guidance for the period ending December 31, 2013, which is reflected in the Company's consolidated financial statements as of and for the period ended December 31, 2013. There was no material impact on the Company's financial statements upon adoption.

#### 3. Acquisitions and Investment

##### Acquisition of Phygen, LLC

On November 6, 2012, the Company closed the acquisition pursuant to the Asset Purchase Agreement (the "Asset Purchase Agreement") with Phygen, LLC ("Phygen"), pursuant to which the Company agreed to purchase Phygen's right, title and interest in and certain assets used by Phygen in connection with the design, development, marketing and distribution of certain of Phygen's spinal implant products, together with the intellectual property rights, contractual rights, inventories and certain liabilities related thereto. At the closing of the transaction the Company issued to Phygen 4,069,087 unregistered shares of the Company's common stock and paid to Phygen \$2 million in cash. The Company placed 1,170,960 unregistered shares of the common stock into an escrow account, which served as security against any potential indemnification obligations of Phygen under the Asset Purchase Agreement for a period of 12 months following the closing. In November 2013, the Company made a claim of 328,356 shares of the Company's common stock against the escrow shares, which were returned to the Company in December 2013. In connection with this release of shares the Company recorded income of \$0.6 million as a reduction of general and administrative expenses in the year ended December 31, 2013. The remaining shares of the Company's common stock held in escrow were released to the owners of Phygen. In addition, pursuant to the Asset Purchase Agreement, the Company paid to Phygen \$4 million in cash in April 2013. In connection with the Phygen acquisition, the Company incurred transaction

related expenses of \$1.1 million in the year ended December 31, 2012. The results of Phygen's operations are included in the consolidated financial statements from November 7, 2012.

F-15

---

ALPHATEC HOLDINGS, INC.  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Based on the closing price of Alphatec's common stock of \$1.69 on November 6, 2012, cash consideration and contingent liabilities, the total purchase price was as follows (in thousands):

Fair value of Alphatec common stock issued upon closing	\$8,856
Cash consideration paid and payable	5,900
Contingent consideration	3,724
 Total purchase price	 \$18,480

Under the acquisition method of accounting, the total purchase price was allocated to Phygen's net tangible and intangible assets was based on their estimated fair values at the date of the completion of the acquisition.

The following table summarizes the allocation of the purchase price for Phygen and the estimated useful lives for the acquired intangible assets (in thousands):

	Useful lives (in years)	Estimated Fair Value
Net tangible assets assumed		\$1,086
Acquired intangibles:		
Developed technology	3	176
Trademarks	3	59
Covenant not-to-compete	3	389
Customer-related intangible	12	5,843
Distribution network	12	2,413
Goodwill		8,514
Total purchase price allocation		\$18,480

The Company allocated \$1.1 million to Phygen's net tangible assets assumed, and \$8.9 million to identifiable intangible assets acquired and \$3.7 million to contingent consideration. A value of \$8.5 million, representing the difference between the total purchase price and the aggregate fair values assigned to the net tangible and intangible assets acquired, less liabilities and contingent consideration assumed, was assigned to goodwill. The Company acquired Phygen to expand its product offerings to Phygen's existing surgeon base. This and other factors contributed to a purchase price for Phygen that resulted in the recognition of goodwill. The amount recorded as acquired intangibles and goodwill is expected to be deductible for tax purposes.

The Company increased the value of inventory it acquired from Phygen to its estimated fair value ("step up"), which represented an amount equivalent to estimated selling prices less distribution related costs and a normative selling profit. Consistent with stock rotation, the inventory step up reversed ratably over 6 months and is included in the Company's post-combination financial statements.

For the technology-related assets, the Company determined the values for each of these categories by estimating the present values of the net cash flows expected to be generated by each category of technology.

The Company calculated the value of the trademark by estimating the present value of future royalty costs that would be avoided by a market participant due to ownership of the trademarks acquired.

The Company calculated the value of the covenant not-to-compete by estimating the difference between the present value of future cash flows with and without the covenant not-to-compete in place.

The customer-related intangible includes hospitals and distributors that take title to Phygen's products. The Company determined the value of such customer-related intangible by estimating the present value of expected future net cash flows derived from such customers.

The distribution network includes U.S.-based distributors that sell Phygen's products to customers on a consignment basis. The Company determined the value of the intangibles related to the distribution network by estimating the difference between the present values of expected future net cash flows generated with and without the distribution network in place.

F-16

---

## ALPHATEC HOLDINGS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The Company calculated the value of the contingent consideration by estimating the present value of future minimum royalty payments due under licensing agreements entered into in connection with the Phygen acquisition. The Company will revalue the contingent consideration each reporting period with an offset to any increase or decrease in the statement of operations.

Pro forma supplemental financial information is not provided as the impact of the Phygen acquisition was not material to operating results in the year ended December 31, 2013 or 2012.

## Acquisition of Cibramed

In January 2011, the Company acquired Cibramed Productos Medicos (“Cibramed”), a Brazilian medical device company. The Company purchased Cibramed to acquire its ANVISA regulatory registration certificates and its general licenses to conduct business in Brazil. The Company recorded an intangible asset of \$0.6 million for the ANVISA regulatory registration certificates and licenses it purchased. The Company is amortizing this asset on a straight-line basis over its estimate life of 15 years. No product distribution rights were acquired. The purchase price of \$0.6 million was paid in installments consisting of (i) 60% upon execution of the acquisition agreement; (ii) 20% due 90 days from the execution of the acquisition agreement and; (iii) 20% due 180 days from the execution of the acquisition agreement. The Company paid the full purchase price of \$0.6 million in 2011.

## 4. Balance Sheet Details

## Accounts Receivable

Accounts receivable consist of the following (in thousands):

	December 31,	
	2013	2012
Accounts receivable	\$42,443	\$42,086
Allowance for doubtful accounts	(1,048	) (1,074
Accounts receivables, net	\$41,395	\$41,012

## Inventories

Inventories consist of the following (in thousands):

	December 31, 2013			December 31, 2012		
	Gross	Reserve for excess and obsolete	Net	Gross	Reserve for excess and obsolete	Net
Raw materials	\$4,375	\$—	\$4,375	\$5,863	\$—	\$5,863
Work-in-process	531	—	531	1,350	—	1,350
Finished goods	60,979	(23,946	) 37,033	59,864	(17,222	) 42,642
Inventories	\$65,885	\$(23,946	) \$41,939	\$67,077	\$(17,222	) \$49,855

## ALPHATEC HOLDINGS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## Property and Equipment

Property and equipment consist of the following (in thousands):

	Useful lives (in years)	December 31,	
		2013	2012
Surgical instruments	4	\$62,636	\$56,712
Machinery and equipment	7	14,692	13,996
Computer equipment	3	3,357	3,269
Office furniture and equipment	5	3,703	3,528
Leasehold improvements	various	4,161	4,092
Building	39	52	64
Land	n/a	10	13
Construction in progress	n/a	1,228	1,045
		89,839	82,719
Less accumulated depreciation and amortization		(61,809	) (52,316
Property and equipment, net		\$28,030	\$30,403

Total depreciation expense was \$14.6 million, \$14.2 million and \$14.8 million for the years ended December 31, 2013, 2012 and 2011, respectively. At December 31, 2013 and 2012, assets recorded under capital leases of \$1.8 million are included in the machinery and equipment balance and \$0.6 million are included in the construction in progress balance. Amortization of assets under capital leases is included in depreciation expense.

## Intangible Assets

Intangibles assets consist of the following (in thousands):

	Useful lives (in years)	December 31,	
		2013	2012
Developed product technology	3-8	\$23,633	\$23,253
Distribution rights	3	2,343	4,281
Intellectual property	5	1,004	1,004
License agreements	1-7	17,686	17,423
Core technology	10	5,137	4,940
Trademarks and trade names	3-9	3,920	3,796
Customer-related	12-15	22,161	19,221
Distribution network	10-12	4,027	3,906
Physician education programs	10	3,160	3,039
Supply agreement	10	225	225
		83,296	81,088
Less accumulated amortization		(44,232	) (34,232
Intangible assets, net		\$39,064	\$46,856

Total amortization expense was \$11.6 million, \$9.6 million and \$5.1 million for the years ended December 31, 2013, 2012 and 2011, respectively.

During the year ended December 31, 2013, the Company decided that it would not continue to market an adult stem cell product sold under the Company's private label name of Puregen. The Company also decided that it would no longer actively market two additional products. The Company expensed \$1.3 million as impairment charges in cost of goods sold in the year ended December 31, 2013 for the write-off of intangible assets related to these products.





ALPHATEC HOLDINGS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The future expected amortization expense related to intangible assets as of December 31, 2013 is as follows (in thousands):

Year Ending December 31,	
2014	\$6,751
2015	6,102
2016	5,608
2017	4,986
2018	3,279
Thereafter	12,338
Total	\$39,064

Accrued Expenses

Accrued expenses consist of the following (in thousands):

	December 31,	
	2013	2012
Legal	\$2,139	\$939
Accounting	928	847
Phygen purchase price	—	3,936
Severance	297	749
Restructuring	9,170	—
Sales milestones	1,828	2,423
Accrued taxes	1,120	1,605
Deferred rent	1,163	1,483
Royalties	2,347	1,911
Commissions	6,180	5,371
Payroll and related	9,369	7,027
Litigation settlements	22,600	4,102
Other	5,855	8,097
Total accrued expenses	\$62,996	\$38,490
Goodwill		

The changes in the carrying amount of goodwill from December 31, 2012 through December 31, 2013 were as follows (in thousands):

	December 31,	
	2013	2012
Balance at December 31, 2012 and 2011	\$180,838	\$168,609
Change in Phygen goodwill	(1,610	) 10,124
Effect of foreign exchange rate on goodwill	3,776	2,105
Balance at December 31,	\$183,004	\$180,838



ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

5. License and Consulting Agreements

License Agreements

In June 2012, the Company entered into a private label supply agreement with a third party supplier whereby the Company acquired exclusive U.S. distribution rights to market a patented synthetic biologic product under its own brand name (the “Biologic Supply Agreement”). The Company made an up-front payment of \$1.0 million in connection upon the execution of the Biologic Supply Agreement. The up-front payment was capitalized as an intangible asset and will be amortized straight-line over the 4-year term of the Biologic Supply Agreement.

In October 2012, the Company entered into a supply agreement with a third party supplier whereby the Company acquired exclusive worldwide distribution rights to sell an anchored, fully retractable cervical inter-body spacer (the “Cervical Spacer Supply Agreement”). The Company was required to make up-front payments totaling \$1.0 million upon the execution of the Cervical Spacer Supply Agreement. The \$1.0 million up-front payments were capitalized as an intangible asset and will be amortized over the 7-year term of the Cervical Spacer Supply Agreement. Additionally, the Company is required to meet certain minimum purchase requirements of up to \$5.9 million per year to maintain its exclusive distribution rights.

OsseoFix Spinal Fracture Reduction System License Agreement

On April 16, 2009, the Company and Stout Medical Group LP (“Stout”) amended the license agreement that the parties had entered into in September 2007 (the “License Amendment”) that provides the Company with a worldwide license to develop and commercialize Stout’s proprietary intellectual property related to a treatment for vertebral compression fractures. The effective date of the License Amendment is March 31, 2009. Under the License Amendment, the timing of the minimum royalty payments has been adjusted and Stout’s ability to terminate the License Amendment was revised. Under the original license agreement, the Company’s minimum royalty obligation began in the year ending December 31, 2009 and there are milestones due upon attainment of sales volumes. Pursuant to the License Amendment, the minimum royalty obligation is suspended until a licensed product obtains regulatory approval from the United States Food and Drug Administration (the “FDA”). In addition, under the terms of the License Amendment, Stout has the ability to terminate the License Amendment if the Company is not using commercially reasonable efforts to obtain regulatory approval to market and sell a licensed product; provided that the Company has the right to delay such termination in exchange for making certain payments to Stout. If, during the time period when such payments are made, the Company were to make a regulatory filing for the marketing and sale of a licensed product, such termination will be null and void. Pursuant to the License Amendment, Stout is entitled to retain all up-front payments that had been previously paid to it. The other material terms of the license agreement were not changed in the License Amendment.

OsseoScrew License Agreement

In December 2007, the Company entered into an exclusive license agreement (the “OsseoScrew License Agreement”), with Progressive Spinal Technologies LLC (“PST”), which provides the Company with an exclusive worldwide license to develop and commercialize PST’s proprietary intellectual property related to an expanding pedicle screw with increased pull-out strength. The financial terms of the OsseoScrew License Agreement include: (i) a cash payment payable following the execution of the agreement; (ii) development and sales milestone payments in cash and the Company’s common stock that began to be achieved and paid in 2008; and (iii) a royalty payment based on net sales of licensed products. The agreement included milestone payments of \$3.6 million consisting of cash and the Company’s common stock upon the completion of the biomechanical testing, which were attained in 2009. Furthermore, the agreement includes milestone payments of \$2.5 million consisting of cash and the Company’s common stock upon market launch.

In November 2010, the Company and PST entered into a fifth amendment to the OsseoScrew License Agreement. The fifth amendment includes (i) a milestone payment of a \$1.5 million and the issuance of \$1.0 million in shares of the

Company's common stock upon market launch in Europe; and (ii) royalty payments based on net sales of licensed products with minimum annual royalties beginning at the end of 2011. During the fourth quarter of 2010, the Company recorded an intangible asset of \$2.5 million for a milestone payment required upon market launch in Europe which consisted of the cash payment of \$1.5 million and \$1.0 million in shares of the Company's common stock. The Company is amortizing this asset over seven years, the estimated life of the product. The total number of shares of common stock which were issued on December 15, 2010, was 452,488.

On December 12, 2013, the Company and PST entered into a sixth amendment to the OsseoScrew License Agreement. The sixth amendment provides (i) the royalty rate paid by the Company for net sales of licensed products is increased; (ii) the territory is amended so that the United States is removed from the territory in which the Company can sell and market licensed

F-20

---

## ALPHATEC HOLDINGS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

products, and such rights are non-exclusive in Russia and the People's Republic of China; (iii) all milestone payments based on the achievement of certain sales milestones are deleted; and (iv) a \$0.3 million milestone payment to be paid upon the achievement of regulatory approval of a licensed product in the People's Republic of China was added. In connection with this amendment the company reversed the \$0.6 million accrual it had recorded for the sales milestone payment into cost of goods sold for the year ended December 31, 2013.

**License Agreement with Helix Point, LLC**

In February 2009, the Company entered into a license agreement (the "Helifuse/Helifix License Agreement") with Helix Point, LLC ("Helix Point") that provides the Company with a worldwide exclusive license (excluding the People's Republic of China) to develop and commercialize Helix Point's proprietary intellectual property related to a device for the treatment of spinal stenosis. The financial terms of the Helifuse/Helifix License Agreement include: (i) a cash payment of \$0.2 million payable following the execution of the Helifuse/Helifix License Agreement; (ii) the issuance of \$0.4 million of shares of the Company's common stock following the execution of the Helifuse/Helifix License Agreement; (iii) development and sales milestone payments in cash and the Company's common stock; and (iv) a royalty payment based on net sales of licensed products, with minimum annual royalties beginning in the year after the first commercial sale of a licensed product. During the third quarter of 2010, the Company recorded an intangible asset of \$0.2 million for the assets received as this product is cleared for sale in Europe and technological feasibility is considered to have been achieved. The Company is amortizing this asset over seven years, the estimated life of the product.

**License Agreement with International Spinal Innovations, LLC**

In June 2009, the Company entered into a cross license agreement (the "ISI License Agreement") with International Spinal Innovations, LLC ("ISI") that provides the Company with a worldwide license to develop and commercialize ISI's proprietary intellectual property related to a stand-alone anterior lumbar interbody fusion device. The financial terms of the ISI License Agreement include: (i) the issuance of 260,000 shares of the Company's common stock following the execution of the ISI License Agreement; (ii) sales milestone payments in cash that could begin to be achieved and paid in 2014; and (iii) a royalty payment based on net sales of licensed products. In 2012, the Company entered into an amended agreement that established a minimum royalty payment amount that began in 2012.

**Distribution Agreement with Parcell Spine, LLC**

In January 2010, the Company entered into an exclusive distribution agreement (the "Parcell Agreement") with Parcell Spine, LLC ("Parcell Spine"), which provides the Company with the exclusive right to distribute Parcell Spine's proprietary adult stem cells for the treatment of spinal disorders under either Parcell's trademarks or Alphatec Spine's private label. The financial terms of the Parcell Agreement include: (i) a cash payment of \$0.5 million payable following the execution of the Parcell Agreement; (ii) a milestone payment consisting of \$1.0 million in cash and the issuance of \$1.0 million of shares of the Company's common stock following the successful completion of a pre-clinical study; and (iii) sales milestone payments in cash and the Company's common stock. During the first quarter of 2010, the Company recorded an IPR&D charge of \$0.5 million for the initial cash payment. During the third quarter of 2010, the pre-clinical study milestone was achieved and the Company recorded an IPR&D charge totaling \$2.0 million, which consisted of a cash payment of \$1.0 million and the issuance of \$1.0 million worth of the Company's common stock. The amounts were expensed as the technological feasibility associated with the IPR&D had not been established since the final prototype of the device had not been completed, additional items subject to risk of completion were necessary to comply with regulatory requirements and no alternative future use exists. The total number of shares of common stock, which were issued in accordance with the agreement for the achievement of a development milestone, was 465,116. In addition, during the third quarter of 2010, the Company recorded an intangible asset of \$1.5 million for a milestone payment required upon market launch when the product became commercially ready for sale which consisted of a cash payment of \$0.5 million and \$1.0 million worth of the

Company's common stock. The Company is amortizing this asset over seven years, the estimated life of the product. The total number of shares of common stock, which were issued in accordance with the agreement for the achievement of a development milestone in September 2010, was 476,190.

During the year ended December 31, 2013, the Company decided that it would not continue to sell its Puregen product, which is currently the only product commercialized by the Company under the Parcell Agreement. During the year ended December 31, 2013, the Company expensed \$0.9 million as impairment charges in cost of goods for the write-off of intangible assets related to the Parcell Agreement and expensed \$2.6 million related to the write-off of inventory and certain prepaid assets in cost of goods sold.

F-21

---

ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

License Agreement with R Tree Innovations LLC

In September 2010, the Company entered into a License Agreement (the "R Tree License Agreement") with R Tree Innovations LLC ("R Tree") that provides the Company with a worldwide license to develop and commercialize R Tree's proprietary intellectual property related to its Epicage interbody fusion device and related instrumentation. The financial terms of the R Tree License Agreement include: (i) a cash payment of \$0.8 million and the issuance of \$0.5 million of the Company's common stock following the execution of the R Tree License Agreement; (ii) development and sales milestone payments in cash that could begin to be achieved and paid in 2013; and (iii) a royalty payment based on net sales of licensed products. During the third quarter of 2010, the Company recorded an intangible asset of \$1.3 million following the execution of the R Tree License Agreement. In November 2012, the Company and R Tree entered into an amendment to the R Tree License Agreement (the "R Tree Amendment"). In connection with the R Tree Amendment the Company made a cash payment of \$0.3 million and issued \$0.2 million worth of its common stock to R Tree. The total consideration of \$0.5 million was recorded as an intangible asset. The Company is amortizing the intangible asset over seven years, the estimated life of the product. The total number of shares of common stock, which were issued in accordance with the R Tree License Agreement and the R Tree Amendment was 367,044. In October 2013, another milestone was reached and the Company made a \$0.3 million cash payment and will issue \$0.2 million worth of its common stock to R Tree. The total consideration of \$0.5 million was recorded as an intangible asset.

6. Debt

MidCap Loan and Security Agreement

On August 30, 2013, the Company entered into an Amended and Restated Credit, Security and Guaranty Agreement (the "Amended Credit Facility") with MidCap. The Amended Credit Facility amended and restated the prior credit facility that the Company had MidCap (the "Credit Facility").

Pursuant to the Amended Credit Facility, the Company increased the borrowing limit from \$50 million to \$73 million. The Company also extended the maturity to August 2016. The Amended Credit Facility consists of a \$28 million term loan drawn at closing with a \$5 million delayed draw within 12 months, for a total term loan maximum borrowing of \$33 million and a revolving line of credit with a maximum borrowing base of \$40 million. The Company used the term loan proceeds of \$28 million to repay a portion of the outstanding balance on the prior revolving line of credit. The term loan interest rate is priced at the London Interbank Offered Rate ("LIBOR") plus 8.0%, subject to a 9.5% floor, and the revolving line of credit interest rate bears interest at LIBOR plus 6.0%, reset monthly. At December 31, 2013, the revolving line of credit carried an interest rate of 6.2% and the term loan carried an interest rate of 9.5%. The borrowing base is determined, from time to time, based on the value of domestic eligible accounts receivable and domestic eligible inventory. As collateral for the Amended Credit Facility, the Company granted MidCap a security interest in substantially all of its assets, including all accounts receivable and all securities evidencing its interests in its subsidiaries.

In addition to monthly payments of interest, monthly repayments of \$0.3 million of the principal for the term loan are due beginning in October 2013 through maturity, with the remaining principal due upon maturity.

In connection with the execution of the Amended Credit Facility, the Company incurred approximately \$0.4 million in costs were capitalized as debt issuance costs. Approximately \$0.4 million of the net remaining unamortized debt issuance costs related to the prior Credit Facility remained within the unaudited consolidated balance sheets, which will be amortized over the term of the Amended Credit Facility.

On June 7, 2012, the Company entered into the prior Credit Facility with MidCap, which permitted the Company to borrow up to \$40 million under a revolving line of credit and included an option to increase the borrowing base to \$50 million with the prior consent of MidCap. As collateral for the Credit Facility, the Company granted MidCap a security interest in substantially all of its assets, including all accounts receivable and all securities evidencing its

interests in its subsidiaries.

Upon execution of the prior Credit Facility, the Company drew \$34.3 million on the Credit Facility to pay off its existing term loan with Silicon Valley Bank (“SVB”) totaling \$8.1 million and its existing line of credit with SVB totaling \$17.6 million (collectively the “SVB Credit Facility”). The Company paid early termination and other fees to SVB associated with the SVB Credit Facility of \$2.3 million and wrote-off \$0.6 million of unamortized debt issuance and debt discount costs related to the SVB Credit Facility. The total loss on extinguishment of debt costs of \$2.9 million is included in interest expense in the nine months ended September 30, 2012. The Company paid an up-front commitment fee to MidCap of \$0.2 million and debt issuance costs of \$0.2 million, which were capitalized as deferred debt issuance costs.

The Amended Credit Facility includes traditional lending and reporting covenants including a fixed charge coverage ratio and a senior leverage ratio to be maintained by the Company. The Amended Credit Facility also includes several potential

F-22

---



## ALPHATEC HOLDINGS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

events of default, such as payment default and insolvency conditions, which could cause interest to be charged at a rate which is up to five percentage points above the rate effective immediately before the event of default or result in MidCap's right to declare all outstanding obligations immediately due and payable. In January 2013, the Company entered into a limited waiver and limited consent agreement with MidCap (the "Waiver"). Under the Waiver, MidCap gave the Company its consent to waive certain provisions of the prior Credit Facility in connection with the acquisition of Phygen and related to the maintenance of cash balances in the U.S. In February 2013, the Company and MidCap entered into a first amendment to the Credit Facility (the "First Amendment"). The First Amendment allowed the Company to exclude payments related to the Phygen acquisition and the settlement agreement with Cross Medical Products, LLC ("Cross") from calculation of the fixed charge coverage ratio and the senior leverage ratio. In conjunction with the First Amendment, the Company paid MidCap a fee of \$0.1 million. In July 2013, the Company entered into a second limited waiver and limited consent agreement with MidCap (the "Second Waiver"). Under the Second Waiver, MidCap gave the Company its consent to waive certain provisions of the prior Credit Facility related to the maintenance of cash balances in the U.S. for past periods through September 30, 2013. On August 30, 2013, the Company entered into the Amended Credit Agreement with MidCap. The Company was in compliance with all of the covenants of the Amended Credit Facility as of December 31, 2013.

During the year ended December 31, 2013, the Company repaid \$168.9 million, including a \$28.0 million repayment using the proceeds from the new term loan, and drew an additional \$154.6 million on its working capital line of credit. The balance of the line of credit and the term loan as of December 31, 2013 was \$24.8 million and \$27.3 million, respectively. Amortization of the debt discount and debt issuance costs, accretion of the finance charge and non-cash extinguishment of debt costs, which were recorded as non-cash interest expense, totaled \$0.2 million, \$0.9 million and \$0.4 million for the years ended December 31, 2013, 2012 and 2011, respectively. Interest expense for the term loans and the Company's working capital line of credit, excluding debt discount and debt issuance cost amortization, accretion of the additional finance charge and extinguishment of debt costs, totaled \$3.6 million, \$2.6 million and \$2.2 million for the years ended December 31, 2013, 2012 and 2011, respectively.

## SVB Loan and Security Agreement

On October 29, 2010, the Company entered into an amended and restated loan and security agreement with SVB (the "SVB Credit Facility"), which was amended in December 2011. The amended SVB Credit Facility consisted of a working capital line of credit, which permitted the Company to borrow up to \$22 million and a \$10 million term loan. The actual amount available was based on eligible accounts receivable and eligible inventory. The term loan carried a fixed interest rate equal to the greater of 8.5% or the SVB prime rate plus 4.5% with principal plus interest repayments due in 16 equal quarterly installments. The term loan matured October 2015 and the Company was subject to a prepayment penalty if the term loan is repaid prior to maturity. In June 2012, the SVB Credit Facility was terminated and replaced by the MidCap Credit Facility.

## Other Debt Agreements

The Company has various capital lease arrangements. The leases bear interest at rates ranging from 6.6% to 9.6%, are generally due in monthly principal and interest installments, are collateralized by the related equipment, and have various maturity dates through June 2017.

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

	December 31,	
	2013	2012
Credit Facility with MidCap	\$52,081	\$38,634
Capital leases (See Note 7)	1,336	1,770
Note payable related to software license purchases	58	59

Edgar Filing: Alphatec Holdings, Inc. - Form 10-K

Financing agreements for premiums on insurance policies	1,427	1,204	
Total debt	54,902	41,667	
Less: current portion	(4,924	) (1,700	)
Total long-term debt	\$49,978	\$39,967	

F-23

---

ALPHATEC HOLDINGS, INC.  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Principal payments on debt are as follows as of December 31, 2013 (in thousands):

Year Ending December 31,		
2014	\$4,485	
2015	3,000	
2016	46,081	
2017	—	
2018	—	
Thereafter	—	
Total	53,566	
Add: capital lease principal payments	1,336	
Total	54,902	
Less: current portion of long-term debt	(4,924	)
Long-term debt, net of current portion	\$49,978	

## 7. Commitments and Contingencies

### Leases

During the first quarter of 2008, the Company entered into a lease agreement and sublease agreement in order to consolidate the use and occupation of its then existing premises into two adjacent facilities, as described below. The Company also leases certain equipment and vehicles under operating leases which expire on various dates through 2018, and certain equipment under capital leases which expire on various dates through 2017.

In February 2008, the Company entered into a sublease agreement (the “Sublease”), for office, engineering, and research and development space. The Sublease term commenced May 2008 and ends on January 31, 2016.

The Company is obligated under the Sublease to pay base rent and certain operating costs and taxes for the building. Monthly base rent payable by the Company was approximately \$80,500 during the first year of the Sublease, increasing annually at a fixed annual rate of 2.5% to approximately \$93,500 per month in the final year of the Sublease. The Company’s rent was abated for months one through seven of the Sublease. At the sublease inception, the Company paid a security deposit in the amount of approximately \$93,500.

In March 2008, the Company entered into a lease agreement (the “Lease”) for additional office, engineering, research and development and warehouse and distribution space. The Lease term commenced on December 1, 2008 and ends on January 31, 2017. The Company is obligated under the Lease to pay base rent and certain operating costs and taxes for the building. The monthly base rent payable by the Company was approximately \$73,500 during the first year of the Lease, increasing annually at a fixed annual rate of 3.0% to approximately \$93,000 per month in the final year of the Lease. The Company’s rent was abated for the months two through eight of the term of the Lease in the amount of \$38,480. At the lease inception, the Company paid a security deposit in the amount of approximately \$293,200 consisting of cash and two letters of credit. Following the Company’s achievement of certain financial milestones, the lessor is obligated to return a portion of the security deposit to the Company. The lessor provided a tenant improvement allowance of \$1.1 million to assist with the configuration of the facility to meet the Company’s business needs.



## ALPHATEC HOLDINGS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Future minimum annual lease payments under the Company's operating and capital leases are as follows (in thousands):

Year ending December 31,	Operating	Capital	
2014	\$3,346	\$527	
2015	2,725	467	
2016	1,363	425	
2017	216	82	
2018	15	—	
Thereafter	—	—	
	\$7,665	1,501	
Less: amount representing interest		(165)	)
Present value of minimum lease payments		1,336	
Current portion of capital leases		(439)	)
Capital leases, less current portion		\$897	

Rent expense under operating leases for the years ended December 31, 2013, 2012 and 2011 was \$3.8 million, \$3.7 million and \$3.7 million, respectively.

## Litigation

In 1998, Eurosurgical, a French company in the business of sales and marketing of spinal implants, entered into a distribution agreement for the United States, Mexico, Canada, India and Australia with Orthotec, LLC, a California company ("Orthotec"). In 2004, Orthotec sued Eurosurgical in connection with a contractual dispute and a final \$9 million judgment was entered against Eurosurgical by a California court in 2006. In 2007, following a default judgment, a federal court in California declared Eurosurgical liable to Orthotec for \$30 million in connection with an intellectual property dispute. In 2006, Eurosurgical's European assets were ultimately acquired by Surgiview, SAS, or Surgiview, in a sale agreement, or the Partial Sale Agreement, approved by a French court. After this sale, Surgiview became a subsidiary of Scient'x in 2006. Orthotec attempted to recover on Eurosurgical's obligations by filing a motion in a California court to add Surgiview to the judgment against Eurosurgical on theories including successor liability and fraudulent conveyance. In February 2007, the California court denied Orthotec's motion, indicating that Orthotec had not carried its burdens of proof. Orthotec chose to not proceed with a further hearing in September 2007.

In June 2004, HealthpointCapital (Luxembourg) I S.à.r.l. acquired a minority (33.1 percent) interest in Scient'x. In July 2005, Scient'x acquired an approximately 73 percent interest in Surgiview. At that time, HealthpointCapital Partners, L.P. (through a Luxembourg subsidiary) held a minority interest in Scient'x, which in turn held an interest in Surgiview, but HealthpointCapital Partners II, L.P. had no ownership interest in Scient'x or Surgiview. On November 21, 2007, more than a year after the Partial Sale Agreement was executed, HealthpointCapital Partners II, L.P. acquired majority ownership of Scient'x. In May 2008, after the acquisition of Scient'x by HealthpointCapital in 2007, Orthotec sued Scient'x, Surgiview, HealthpointCapital LLC and certain former directors of Scient'x (who also serve on the Company's board) in a new action in California state court in which it sought (in addition to damages related to other causes of action and punitive damages related thereto) to have the defendants bear responsibility for the \$39 million in judgments that had been assessed against Eurosurgical, which, together with interest is now greater than \$70 million. On February 10, 2014 the jury reached a verdict in which Surgiview was found to have transferred assets for less than fair market value in connection with Surgiview's purchase of certain assets of Eurosurgical, and to have interfered with certain contractual rights of Orthotec. Although a formal judgment has not yet been entered, the jury awarded monetary damages in the amount of \$47.9 million, plus interest, against Surgiview related to various causes of action alleged by Orthotec.

In addition, also in May 2008, a similar action was filed in New York against HealthpointCapital, HealthpointCapital LLC, HealthpointCapital Partners, L.P., HealthpointCapital Partners II, L.P., Scient'x and two former directors of Scient'x (who also serve on the Company's board), in which Orthotec sought, in addition to damages related to other causes of action and punitive damages related thereto, to have the defendant's bear responsibility for the \$39 million in judgments that had been assessed against EuroSurgical, which, together with interest is now greater than \$70 million. On March 15, 2014, the Company, Orthotec, LLC and certain other parties, including certain directors and affiliates of the Company, entered into a binding term sheet to settle all legal matters involving the Company and its directors and affiliates. Pursuant to the term sheet, the Company has agreed to pay Orthotec \$49 million in cash, with initial cash payments totaling \$1.75 million by March 31, 2014 and an additional \$15.75 million payment within 25 days of the Company closing a financing

F-25

---

ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

that would enable it to make such payment, but in no event no later than June 15, 2014. The remaining \$31.5 million will be paid to Orthotec in installments of \$1.1 million paid quarterly, beginning in the fourth quarter of 2014. HealthpointCapital has agreed to contribute \$5 million to the \$49 million settlement amount. In addition, a 7% simple interest rate will accrue on the unpaid portion of the \$31.5 million. All accrued interest is not payable until the \$49 million is paid, and such accrued interest shall be paid in \$1.1 million installments each quarter. This settlement will result in mutual releases of all claims and the dismissal of all Orthotec-related litigation matters involving the Company, its directors and affiliates.

On August 10, 2010, a purported securities class action complaint was filed in the United States District Court for the Southern District of California on behalf of all persons who purchased the Company's common stock between December 19, 2009 and August 5, 2010 against and certain of its directors and officers alleging violations of the Securities Exchange Act of 1934, as amended, and Rule 10b-5 promulgated thereunder. On February 17, 2011, an amended complaint was filed against the Company and certain of its directors and officers adding alleged violations of the Securities Act of 1933, as amended. HealthpointCapital, Jefferies & Company, Inc., Canaccord Adams, Inc., Cowen and Company, Inc., and Lazard Capital Markets LLC are also defendants in this action. The complaint alleges that the defendants made false or misleading statements, as well as failed to disclose material facts, about the Company's business, financial condition, operations and prospects, particularly relating to the Scient'x transaction and our financial guidance following the closing of the acquisition. The complaint seeks unspecified monetary damages, attorneys' fees, and other unspecified relief. The Company believe that the claims are without merit and it intends to vigorously defend itself against this complaint. However, the outcome of the litigation cannot be predicted at this time and any outcome that is adverse to the Company, regardless of who the defendant is, could have a significant adverse effect on its financial condition and results of operations.

On August 25, 2010, an alleged shareholder of the Company's filed a derivative lawsuit in the Superior Court of California, San Diego County, purporting to assert claims on behalf of the Company against all of its directors and certain of its officers and HealthpointCapital. Following the filing of this complaint, similar complaints were filed in the same court and in the U.S. District Court for the Southern District of California against the same defendants containing similar allegations. The complaint filed in federal court was dismissed by the plaintiff without prejudice in July 2011. The state court complaints have been consolidated into a single action and the Company has been named as a nominal defendant in the consolidated action. Each complaint alleges that the Company's directors and certain of its officers breached their fiduciary duties to the Company related to the Scient'x transaction, and by making allegedly false statements that led to unjust enrichment of HealthpointCapital and certain of the Company's directors. The complaints seek unspecified monetary damages and an order directing the Company to adopt certain measures purportedly designed to improve its corporate governance and internal procedures. On January 8, 2014, the parties reached an agreement in principle to resolve all claims in exchange for corporate governance reforms and payment of attorneys' fees in the amount of \$5.25 million, to be paid by the Company's and HeathpointCapital's respective insurance carriers. The Company believes the claims are without merit and, subject to final approval of any settlement, intends to vigorously defend itself against these complaints. No assurances can be given as to the timing or outcome of this lawsuit.

At December 31, 2013, the probable outcome of any of the aforementioned litigation matters cannot be determined nor can the Company estimate a range of potential loss. Accordingly, in accordance with the authoritative guidance on the evaluation of contingencies, the Company has not recorded an accrual related to these litigation matters. The Company is and may become involved in various other legal proceedings arising from its business activities. While management does not believe the ultimate disposition of these matters will have a material adverse impact on the Company's consolidated results of operations, cash flows or financial position, litigation is inherently unpredictable, and depending on the nature and timing of these proceedings, an unfavorable resolution could materially affect the

Company's future consolidated results of operations, cash flows or financial position in a particular period.

#### Royalties

The Company has entered into various intellectual property agreements requiring the payment of royalties based on the sale of products that utilize such intellectual property. These royalties primarily relate to products sold by Alphatec Spine and are calculated either as a percentage of net sales or in one instance on a per-unit sold basis. Royalties are included on the accompanying consolidated statement of operations as a component of cost of revenues.

#### 8. Redeemable Preferred Stock and Stockholders' Equity

##### Redeemable Preferred Stock

The Company issued shares of redeemable preferred stock in connection with its initial public offering in June 2006. As of December 31, 2013, the redeemable preferred stock carrying value was \$23.6 million and there were 20 million shares of redeemable preferred stock authorized. The redeemable preferred stock is not convertible into common stock but is redeemable

F-26

---



## ALPHATEC HOLDINGS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

at \$9.00 per share, (i) upon the Company's liquidation, dissolution or winding up, or the occurrence of certain mergers, consolidations or sales of all or substantially all of the Company's assets, before any payment to the holders of the Company's common stock, or (ii) at the Company's option at any time. Holders of redeemable preferred stock are generally not entitled to vote on matters submitted to the stockholders, except with respect to certain matters that will affect them adversely as class, and are not entitled to receive dividends. The carrying value of the redeemable preferred stock was \$7.11 per share at December 31, 2013 and 2012.

The redeemable preferred stock is required to be shown in the Company's financial statements separate from stockholders' equity and any adjustments to its carrying value to its redemption value up to its redemption value of \$9.00 per share will be reported as a dividend.

#### Eclipse Advisors, LLC

On May 8, 2012, the Company entered into an equity line of credit arrangement with Eclipse Advisors, LLC ("Eclipse"), which provides that, upon the terms and subject to the conditions set forth therein, the Company is entitled to sell and Eclipse is committed to purchase up to \$25 million of shares of the Company's common stock over a 24-month term (the "Investment Agreement"). From time to time, and at the Company's sole discretion, the Company may present Eclipse with put notices, to purchase the Company's common stock in two tranches over a 31-day period (a "put period") with each put period subject to being reduced by the Company based on a minimum threshold price of the Company's common stock during the put period. The Company may not present Eclipse with a new put notice at any time there is an outstanding put notice.

Once presented with a put notice, Eclipse is required to purchase: (i) 50% of the dollar amount of the shares specified in the put notice on the 16th day after the date of the put notice; and (ii) 50% of the dollar amount of the shares specified in the put notice on the 31st day after the date of the put notice. The price per share for the sale of such common stock for each of the two closings in a put period shall be 90% of the volume weighted average price for the Company's common stock over the trading days that exist during the 15 days prior to such closing date. If the daily volume weighted average price of the Company's common stock falls below a threshold price established by the Company on any trading day during a put period, the Company has the right to send a cancellation notice to Eclipse, which will reduce the Company's obligation to sell the shares to Eclipse to no greater than 50% of the dollar amount set forth in the put notice.

Upon execution of the Investment Agreement and as provided for therein, the Company issued Eclipse 231,045 shares of common stock representing a \$500,000 commitment fee, determined by dividing \$500,000 by the volume weighted average price for the Company's common stock for the five trading days preceding the effective date of the Investment Agreement. The Company has not sold any shares to Eclipse under the Investment Agreement.

#### 9. Stock Benefit Plans and Stock-Based Compensation

In 2005, the Company adopted its 2005 Employee, Director, and Consultant Stock Plan (the "2005 Plan"). The 2005 Plan allows for the grant of options and restricted stock awards to employees, directors, and consultants of the Company. The 2005 Plan has 14,200,000 shares of common stock reserved for issuance. The Board of Directors determines the terms of the restricted stock and the term of each option, option price, number of shares for which each option is granted, whether restrictions will be imposed on the shares subject to options, and the rate at which each option is exercisable. Options granted under the 2005 Plan expire no later than 10 years from the date of grant (5 years for incentive stock options granted to holders of more than 10% of the Company's voting stock). Options generally vest over a four year period and may be immediately exercisable upon a change of control of the Company. The exercise price of incentive stock options may not be less than 100% of the fair value of the Company's common stock on the date of grant. The exercise price of any option granted to a 10% stockholder may be no less than 110% of the fair value of the Company's common stock on the date of grant. At December 31, 2013, approximately 3,200,000 shares of common stock remained available for issuance under the 2005 Plan.



## ALPHATEC HOLDINGS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## Stock Options

A summary of the Company's stock option activity under the 2005 Plan and related information is as follows (in thousands, except as indicated and per share data):

	Shares	Weighted average exercise price	Weighted average remaining contractual term (in years)	Aggregate intrinsic value
Outstanding at December 31, 2012	4,920	\$2.51	8.03	\$64
Granted	4,541	\$1.90	—	—
Exercised	(6	) \$1.54	—	—
Forfeited	(1,645	) \$2.12	—	—
Outstanding at December 31, 2013	7,810	\$2.23	7.59	\$753
Options vested and exercisable at December 31, 2013	2,640	\$2.79	6.10	\$125
Options vested and expected to vest at December 31, 2013	7,218	\$2.26	7.51	\$679

The weighted-average grant-date fair value of stock options granted during the years ended December 31, 2013, 2012 and 2011 was \$1.09, \$1.10 and \$1.48, respectively. The aggregate intrinsic value of options at December 31, 2013 is based on the Company's closing stock price on that date of \$2.01 per share.

As of December 31, 2013, there was \$3.3 million of unrecognized compensation expense for stock options and awards which is expected to be recognized on a straight-line basis over a weighted average period of approximately 2.7 years. The total intrinsic value of options exercised was immaterial for the years ended December 31, 2013 and 2012. The total intrinsic value of options exercised for the year ended December 31, 2011 was \$0.1 million.

On November 19, 2012, the Company commenced a stock option exchange offer for its U.S. employees. The options eligible for exchange had an exercise price equal to or greater than \$2.85. The exercise price of the exchanged options was the higher of 115% of the closing price of the Company's common stock on the exchange date and \$2.00. The exchange offer occurred on December 19, 2012 and the exercise price for the exchanged options was \$2.05. A total of 1,109,604 options to purchase shares of the Company's common stock were exchanged. Many of the outstanding options were either partially or fully vested. The exchanged options will be unvested upon issuance and will vest over 3 years, with one-third of each option vesting on the first anniversary date and the remaining portion of each option vesting in equal quarterly installments over the eight quarters following the first anniversary date.

## Restricted Stock Awards

The following table summarizes information about the restricted stock awards activity (in thousands, except as indicated and per share data):

	Shares	Weighted average grant date fair value	Weighted average remaining recognition period (in years)
Unvested at December 31, 2012	877	\$1.81	1.49

Edgar Filing: Alphatec Holdings, Inc. - Form 10-K

Awarded	375	\$1.97	
Vested	(375)	) \$1.84	
Forfeited	(70)	) \$1.65	
Unvested at December 31, 2013	807	\$1.88	2.30

The weighted average fair value per share of awards granted during the years ended December 31, 2013, 2012 and 2011 was \$1.97, \$1.57 and \$2.61, respectively.

F-28

---

## ALPHATEC HOLDINGS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## Warrants

In March 2012, the Company entered into a consulting agreement with a third-party entity and pursuant to such consulting agreement, the Company issued a warrant to the consultant to purchase an aggregate of 500,000 shares of the Company's common stock at an exercise price of \$2.50 per share. The warrant expires on March 1, 2015 and is 100% vested on December 31, 2013.

In December 2011, in connection with the third amendment to the SVB Credit Facility, finance charges totaling \$0.2 million were waived in exchange for the issuance to SVB of warrants to purchase 93,750 shares of the Company's common stock. The warrants are immediately exercisable, can be exercised through a cashless exercise, have an exercise price of \$1.60 per share and have a ten year term. The Company recorded the value of the warrants of \$0.1 million as a debt discount. The value of the warrants was determined on the date of grant using the Black-Scholes-Merton valuation method with the following assumptions: risk free interest rate of 1.23%, volatility of 57.4%, a ten year term and no dividend yield.

## Elite Medical Holdings and Pac 3 Surgical Products Agreement

In October 2013, the Company entered into a three-year collaboration agreement with a third party to provide consultation services to assist the Company in the development of its products and its products in development. Under the terms of the collaboration agreement, the Company will gain exclusive rights to the use of all intellectual property developed by the collaborators. The Company will make three annual payments to the collaborator as sole consideration for services provided, totaling an aggregate of up to \$8 million, paid in common stock of Alphatec Holdings at a per share price of \$1.95, which was equal to the average NASDAQ closing price of the common stock on the five days leading up to and including the date of signing the collaboration agreement. The actual number of shares issued each year will be determined by the fair market value of the services provided over the prior 12 months. In 2013, the Company issued 128,571 shares of its common stock under this agreement.

## Media Advertising Agreement

In 2012, the Company entered into consulting agreements with a third-party entity for marketing and advertising services. In connection with these agreements the Company paid the consultant \$0.2 million, issued 500,000 registered shares of the Company's common stock and issued 352,000 unregistered shares of the Company's common stock. In May 2013, the Company entered into an additional consulting agreement with a third-party entity for marketing and advertising services. In connection with this agreement the Company paid the consultant total cash consideration of \$0.2 million and issued 225,000 restricted shares of the Company's common stock. The Company recorded total stock compensation related to these agreements during the years ended December 31, 2013 and 2012 of \$0.7 million and \$1.1 million, respectively.

## Common Stock Reserved for Future Issuance

Common stock reserved for future issuance consists of the following (in thousands):

	December 31, 2013
Stock options outstanding	7,810
Awards outstanding	807
Warrants outstanding	594
Authorized for future grant under 2005 Plan	3,166
	12,377



## ALPHATEC HOLDINGS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## 10. Income Taxes

The components of the pretax loss from operations for the years ended December 31, 2013, 2012 and 2011 are as follows (in thousands):

	Year Ended December 31,			
	2013	2012	2011	
U.S. Domestic	\$ (9,264	) \$ (3,310	) \$ (14,400	)
Foreign	(69,784	) (13,308	) (12,288	)
Pretax loss from operations	\$ (79,048	) \$ (16,618	) \$ (26,688	)

The components of the (benefit) provision for income taxes are presented in the following table (in thousands):

	Year Ended December 31,			
	2013	2012	2011	
Current:				
Federal	\$ (21	) \$ 107	\$ 4	
State	186	24	222	
Foreign	2,525	2,083	(388	)
Total current provision (benefit)	2,690	2,214	(162	)
Deferred:				
Federal	229	137	163	
State	15	29	8	
Foreign	245	(3,539	) (4,516	)
Total deferred provision (benefit)	489	(3,373	) (4,345	)
Total provision (benefit)	\$ 3,179	\$ (1,159	) \$ (4,507	)

The (benefit) provision for income taxes differs from the amount of income tax determined by applying the applicable U.S. statutory federal income tax rate to pretax income as a result of the following differences:

	December 31,					
	2013	)%	2012	)%	2011	)%
Federal statutory rate	(35.0	)%	(35.0	)%	(35.0	)%
Adjustments for tax effects of:						
State taxes, net	(0.1	)%	(0.0	)%	(0.7	)%
Stock-based compensation	0.5	%	(0.5	)%	1.8	%
Foreign taxes	1.1	%	(0.1	)%	3.6	%
Tax credits	(0.4	)%	(0.7	)%	(1.2	)%
Deemed foreign dividend	—	%	0.2	%	10.3	%
Intercompany debt forgiveness and other permanent adjustments	9.5	%	5.0	%	0.8	%
Tax rate adjustment	0.2	%	0.7	%	(0.5	)%
Uncertain tax positions	2.7	%	14.9	%	(1.5	)%
Other	(0.4	)%	3.3	%	(3.1	)%
Valuation allowance	25.9	%	5.2	%	8.7	%
	4.0	%	(7.0	)%	(16.8	)%

The 2013 provision for income taxes primarily consists of an increase in unrecognized tax benefits associated with the European operations, tax expense related to non-income based state tax in the U.S. and current year income in Japan and Brazil, and an increase in the deferred tax liability related to tax-deductible goodwill in the U.S.

F-30

---



ALPHATEC HOLDINGS, INC.  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Significant components of the Company's deferred tax assets and liabilities as of December 31, 2013 and 2012 are as follows (in thousands):

	December 31,	
	2013	2012
Deferred tax assets:		
Allowances and reserves	\$816	\$1,088
Accrued expenses	3,685	648
Inventory reserves	7,549	7,839
Net operating loss carryforwards	26,497	28,786
Property and equipment	1,171	—
Stock-based compensation	2,769	1,866
Legal settlement	17,998	4,156
Income tax credit carryforwards	1,800	1,276
	62,285	45,659
Valuation allowance	(56,690	) (36,031
Total deferred tax assets, net of valuation allowance	5,595	9,628
Deferred tax liabilities:		
Property and equipment	—	926
Intangible assets	4,806	6,910
Goodwill	1,256	1,011
Total deferred tax liabilities	6,062	8,847
Net deferred tax assets (liabilities)	\$(467	) \$781

The realization of deferred tax assets may be dependent on the Company's ability to generate sufficient income in future years in the associated jurisdiction to which the deferred tax assets relate. The Company considers all available positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies, and recent financial performance. Based on the review of all positive and negative evidence, including a three year cumulative pre-tax loss, it was concluded that a full valuation allowance of \$56.7 million should be recorded against all U.S. and European deferred tax assets at December 31, 2013. During 2012, it was determined that the Company was more-likely-than-not to realize its Japanese deferred tax assets. The Company removed the valuation allowance on the Japanese deferred tax assets and recognized a tax benefit of \$1.4 million in 2012. In the event that the Company were to determine that it would not be able to realize all or part of its Japanese deferred tax assets in the future, it would increase the valuation allowance and recognize a corresponding tax provision in the period in which it made such a determination. Likewise, if the Company later determines that it is more-likely-than-not to realize all or a portion of the U.S. or European deferred tax assets, it would reverse the previously provided valuation allowance.

At December 31, 2013, the Company has unrecognized tax benefits of \$7.8 million of which \$7.2 million will affect the effective tax rate if recognized when the Company no longer has a valuation allowance offsetting its deferred tax assets.

ALPHATEC HOLDINGS, INC.  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table summarizes the changes to unrecognized tax benefits for the years ended December 31, 2013, 2012 and 2011 (in thousands):

Balance at December 31, 2010	\$4,421	
Additions based on tax positions related to the prior year	73	
Additions based on tax positions related to the current year	399	
Reductions as a result of positions taken	(59)	)
Reductions as a result of lapse of applicable statute of limitations	(649)	)
Additions as a result of foreign exchange rates and other	12	
 Balance at December 31, 2011	 \$4,197	
Additions based on tax positions related to the prior year	987	
Additions based on tax positions related to the current year	743	
Reductions as a result of lapse of applicable statute of limitations	(58)	)
Additions as a result of foreign exchange rates and other	28	
 Balance at December 31, 2012	 \$5,897	
Additions based on tax positions related to the prior year	221	
Additions based on tax positions related to the current year	1,664	
Reductions as a result of lapse of applicable statute of limitations	(20)	)
Additions as a result of foreign exchange rates and other	73	
 Balance at December 31, 2013	 \$7,835	

The Company believes it is reasonably possible it will not materially reduce its unrecognized tax benefits within the next 12 months.

The Company and its subsidiaries are subject to federal income tax as well as income tax of multiple state and foreign jurisdictions. With few exceptions, the Company is no longer subject to income tax examination by tax authorities in major jurisdictions for years prior to 2008. However, to the extent allowed by law, the taxing authorities may have the right to examine prior periods where NOLs and tax credits were generated and carried forward, and make adjustments up to the amount of the carryforwards. The Company is not currently under examination by the IRS, foreign or state and local tax authorities.

During 2013, the IRS completed its income tax examination of the 2011 tax year, which resulted in no material adjustments.

The Company recognizes interest and penalties related to uncertain tax positions as a component of the income tax provision. As of December 31, 2013, accrued interest and penalties were \$1.3 million and this amount primarily relates to the uncertain tax positions of the Scient'x operations and state positions. During 2013, there was an increase of \$0.9 million in the accrued interest and penalties related to the uncertain tax positions of the Scient'x operations. At December 31, 2013, the Company had federal and state net operating loss carryforwards of \$39.8 million and \$52.9 million, respectively, expiring at various dates through 2033. At December 31, 2013, the Company had federal and state research and development tax credits of \$2.7 million and \$2.3 million, respectively. The federal research and development tax credits expire at various dates through 2033, while the state credits do not expire. The Company had foreign net operating loss carryforwards of \$41.0 million beginning to expire in 2018. Utilization of the net operating loss and tax credit carryforwards may become subject to annual limitations due to ownership change limitations that

could occur in the future as provided by Section 382 of the Internal Revenue Code of 1986, as amended, as well as similar state and foreign provisions. These ownership changes may limit the amount of the net operating loss and tax credit carryforwards that can be utilized annually to offset future taxable income. An ownership change occurred during June 2006 in connection with the initial public offering. The annual limitation as a result of that ownership change did not result in the loss or substantial limitation of net operating loss or tax credit carryforwards. There have been no subsequent ownership changes through December 31, 2013.

The Company does not record U.S. income taxes on the undistributed earnings of its foreign subsidiaries based upon the Company's intention to permanently reinvest undistributed earnings to ensure sufficient working capital and further expansion of existing operations outside the United States. The undistributed earnings of the foreign subsidiaries as of December 31, 2013

F-32

---

## ALPHATEC HOLDINGS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

are immaterial. In the event the Company is required to repatriate funds from outside of the United States, such repatriation would be subject to local laws, customs, and tax consequences.

## 11. Segment and Geographical Information

Operating segments are defined as components of an enterprise for which separate financial information is available and evaluated regularly by the chief operating decision maker, or decision-making group, in deciding how to allocate resources and in assessing performance. The Company operates in one reportable business segment.

During the years ended December 31, 2013, 2012 and 2011, the Company operated in two geographic regions, the U.S. and International which consists of locations outside of the U.S. In the International geographic location, sales in Japan for the years ended December 31, 2013, 2012 and 2011 totaled \$28.0 million, \$28.6 million and \$23.9 million, respectively, which represented greater than 10 percent of the Company's consolidated revenues for the years then ended December. For the years ended December 31, 2013, 2012 and 2011, sales in other individual countries included in International did not exceed 10 percent of consolidated revenues.

Revenues attributed to the geographic location of the customer were as follows (in thousands):

	Year Ended December 31,		
	2013	2012	2011
United States	\$134,951	\$130,476	\$133,824
International	69,773	65,802	63,887
Total consolidated revenues	\$204,724	\$196,278	\$197,711

Total assets by region were as follows (in thousands):

	December 31,	
	2013	2012
United States	\$196,383	\$213,912
International	169,247	168,215
Total consolidated assets	\$365,630	\$382,127

## 12. Related Party Transactions

For the years ended December 31, 2013, 2012 and 2011, the Company incurred costs of \$0.2 million, \$0.2 million and \$0.1 million, respectively, to Foster Management Company and HealthpointCapital, LLC for travel and administrative expenses, including the use of Foster Management Company's airplane. Foster Management Company is an entity owned by John H. Foster, a member of the Company's board of directors. John H. Foster is a significant equity holder of HealthpointCapital, LLC, an affiliate of HealthpointCapital Partners, L.P. and HealthpointCapital Partners II, L.P., which are the Company's principal stockholders.

## Indemnification Agreements

The Company has entered into indemnification agreements with certain of its directors which are named defendants in the New York matter (See Note 7 - Commitments and Contingencies - Litigation). The indemnification agreements require the Company to indemnify these individuals to the fullest extent permitted by applicable law and to advance expenses incurred by them in connection with any proceeding against them with respect to which they may be entitled to indemnification by the Company. For the years ended December 31, 2013 and 2012, the Company paid approximately \$1.7 million and \$2.6 million, respectively, in connection with the indemnification obligations of Scient'x and Surgiview, all of which was related to the Orthotec matter. (See Note 7)

## 13. Retirement Plan

The Company maintains an employee savings plan that qualifies as a deferred salary arrangement under Section 401(k) of the Internal Revenue Code. Under the savings plan, participating employees may contribute a

portion of their pre-tax earnings, up to the Internal Revenue Service annual contribution limit. Additionally, the Company may elect to make matching contributions into the savings plan at its sole discretion of up to 4% of each individual's compensation. Match amounts are

F-33

---

## ALPHATEC HOLDINGS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

vested after one year of service. The Company's total contributions to the 401(k) plan were \$0.6 million, \$0.5 million and \$0.5 million for the years ended December 31, 2013, 2012 and 2011, respectively.

## 14. Restructuring Activities

On September 16, 2013, the Company announced that Scient'x has begun a process to significantly restructure its business operations in France in an effort to improve operating efficiencies and rationalize its cost structure. The restructuring includes an expected reduction in Scient'x's workforce and closing of the manufacturing facilities in France. The Company estimates that it will record total costs, including employee severance, social plan benefits and related taxes, facility closing costs, manufacturing transfer costs, and contract termination costs of approximately \$12 million associated with this restructuring. In accordance with ASC Topic 420, Accounting for Costs Associated with Exit or Disposal Activities and ASC Topic 712, Non retirement Postemployment Benefits, the Company has recorded a restructuring charge accrual in accrued expenses of \$9.2 million within the consolidated balance sheets as of December 31, 2013 and restructuring expenses of \$9.7 million within the consolidated statements of operations for the year ending December 31, 2013. The Company estimates that it will record severance and benefits of approximately \$9.7 million and facility closing and other restructuring costs of approximately \$2.2 million. The Company expects to complete all the activities associated with the restructuring activities by the end of the second quarter of 2014, a substantial portion of which will be paid by then.

In connection with the restructuring plan, the Company modified its estimate of inventory and instrument net book value at its Scient'x entities based on revised global demand. The Company recorded an additional inventory reserve of \$4.9 million in the year ended December 31, 2013 included in cost of goods sold within the consolidated statements of operations.

Below is a table of the movement (in thousands):

	Expensed December 31, 2013	Paid and Other	Accrued December 31, 2013	Total Costs	Remaining Costs
Social plan	\$8,893	\$(84)	) \$8,809	\$9,705	\$535
French non-social plan costs	210	(210)	) —	2,162	2,162
US booked social cost	361	—	) 361	—	—
US costs other	201	(201)	) —	—	—
Total	\$9,665	\$(495)	) \$9,170	\$11,867	\$2,697

## 15. Cross Medical

On February 12, 2010, a complaint was filed in the U.S. District Court for the Central District of California, by Cross Medical Products, LLC, or Cross, (a subsidiary of Biomet), Cross Medical Products, LLC v. Alphatec Spine, Inc., Case No. 8:10-cv-176-MRP -MLG, alleging that we breached a patent license agreement with Cross by failing to make certain royalty payments allegedly due under the agreement. Cross was seeking payment of prior royalties allegedly due from the Company's sales of polyaxial screws and an order from the court regarding payment of future royalties by us. In its complaint, Cross alleged a material amount of damages were due to it as a result of our alleged breach of the patent license agreement.

In January 2011, we filed a complaint in the U.S. District Court for the Southern District of California against Biomet, Inc., or Biomet, alleging that Biomet's TPS-TL products infringe one of our patents. On December 30, 2011, we reached a global settlement agreement of the pending lawsuits with Biomet and Cross. Under the terms of the settlement, all parties obtained a release of all claims that were the subject of the disputes. No party has admitted

liability in connection with the settlement. The settlement also includes an amendment to the April 23, 2003 License Agreement.

As part of the settlement, we agreed to pay Cross an initial payment of \$5 million, which payment was made in January 2012. In addition to the initial payment, we will make thirteen quarterly payments of \$1 million beginning on August 1, 2012, with each subsequent payment due three months thereafter until the final payment is made in August 2015. The remaining cash obligations totaling \$7 million will be paid as follows: \$4 million in 2014 and \$3 million in 2015. In addition, pursuant to the settlement, the parties have exchanged covenants not to sue for patent infringement with respect to products that each respective company had on the market as of December 30, 2011.

F-34

---





## ALPHATEC HOLDINGS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

## 17. Subsequent Events

## Orthotec LLC, Litigation Settlement

On March 15, 2014, the Company, Orthotec and certain other parties, including certain directors and affiliates of the Company entered into a binding term sheet to settle the pending litigation in the Orthotec, LLC vs. Surgical S.A.S. legal matter (See Note 7) and all other litigation matters related to the Company and its directors and affiliates. Pursuant to the term sheet, the Company has agreed to pay Orthotec \$49 million in cash payments totaling \$1.75 million by March 31, 2014 and an additional \$15.75 million payment due by within 25 days of the closing of the Facility Agreement (as defined below). The remaining \$31.5 million will be paid to Orthotec in 28 quarterly installments of \$1.1 million beginning in the fourth quarter of 2014. HealthpointCapital has agreed to contribute \$5 million to the \$49 million settlement amount. In addition, a 7% simple interest rate will accrue on the unpaid portion of the \$31.5 million which will be paid in \$1.1 million quarterly payments after the \$49 million settlement amount is paid. The Company anticipates to fund a portion of the 2014 payment obligations with proceeds from the Facility Agreement described below. The \$49 million settlement was accrued at its present value of \$46.2 million as of December 31, 2013.

## Deerfield Facility Agreement

On March 17, 2014, the Company entered into a facility agreement (the “Facility Agreement”) with Deerfield Private Design Fund II, L.P., Deerfield Private Design International II, L.P., Deerfield Special Situations Fund, L.P. and Deerfield Special Situations International Master Fund, L.P. (collectively “Deerfield”), pursuant to which Deerfield agreed to loan the Company up to \$50 million, subject to the terms and conditions set forth in the Facility Agreement. Under the terms of the Facility Agreement, the Company has the option, but is not required, upon certain conditions to draw the entire amount available under the Facility Agreement, at any time until January 30, 2015 (the “Draw Period”), provided that the initial draw be used for a portion of the payments made in connection with the Orthotec settlement described above. Following such initial draw down, the Company may draw down additional amounts under the Facility Agreement up to an aggregate \$15 million for working capital or general corporate purposes in \$2.5 million increments until the end of the Draw Period. In addition, in the event the Litigation Satisfaction has not occurred prior to December 15, 2014, the Company may request no later than January 30, 2015 a draw of the entire amount available under the Facility Agreement; provided that such amount will remain in a special deposit account until the Litigation Satisfaction occurs. The Company has agreed to pay Deerfield, upon each disbursement of funds under the Facility Agreement, a transaction fee equal to 2.5% of the principal amount of the funds disbursed. Amounts borrowed under the Facility Agreement bear interest at a rate of 8.75% per annum and are payable on the third, fourth and fifth anniversary date of the first amount borrowed under the Facility Agreement, with the final payment due no later than December 15, 2019.

The Facility Agreement also contains various representations and warranties, and affirmative and negative covenants, customary for financings of this type, including restrictions on the ability of the Company and its subsidiaries to incur additional indebtedness or liens on its assets, except as permitted under the Facility Agreement. As security for our repayment of our obligations under the Facility Agreement, we granted to Deerfield a security interest in substantially all of our property and interests in property that are subordinated to the security interest granted under the Amended Credit Facility.

In connection with the execution of the Facility Agreement, on March 17, 2014, the Company issued to Deerfield warrants to purchase an aggregate of 6,250,000 shares of the Company’s common stock immediately exercisable at an exercise price initially equal to \$1.39 (the “Initial Warrants”) expiring on March 17, 2020. The number of shares of common stock into which the Warrants are exercisable and the exercise price will be adjusted to reflect any stock splits, payment of stock dividends, recapitalizations, reclassifications or other similar adjustments in the number of

outstanding shares of the Company's common stock.

Each disbursement borrowing under the Facility Agreement shall be accompanied by the issuance to Deerfield of warrants to purchase up to 10,000,000 shares of the Company's common stock, at an exercise price equal to the lesser of the Initial Warrant exercise price or the average daily volume weighted average price per share of the Company's common stock for the 15 days following the request for borrowing (the "Draw Warrants"). The number of Draw Warrants issued for each draw will be in proportion to the amount of draw compared to the total \$50 million facility. The number of shares of common stock into which a warrant is exercisable and the exercise price of any warrant will be adjusted to reflect any stock splits, recapitalizations or similar adjustments in the number of outstanding shares of common stock. The warrants have the same dividend rights to the same extent as if the warrants were exercised into shares of common stock.

F-36

---

ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

On March 19, 2014, the Company made an initial draw under the Facility Agreement and received net proceeds of \$19.5 million to fund its 2014 Orthotec settlement payment obligations. In connection with this borrowing, the Company issued 4,000,000 Draw Warrants at an exercise price of \$1.39.

MidCap Amendment

On March 17, 2014, the Company entered into a first amendment to the Amended Credit Facility (the “First Amendment”) with MidCap. Under the First Amendment, MidCap gave the Company its consent to enter into the Facility Agreement and make settlement payments in connection with the Orthotec Litigation. The First Amendment also added a total leverage ratio financial covenant.

F-37

---

ALPHATEC HOLDINGS, INC.  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

SCHEDULE II—VALUATION AND QUALIFYING ACCOUNTS

	Allowance for Doubtful Accounts (1) (In thousands)	Reserve for Excess and Obsolete Inventories (2)	
Balance at December 31, 2010	\$ 1,154	\$ 11,030	
Provision	1,094	4,564	
Write-offs and recoveries, net	(1,193	) (2,420	)
Balance at December 31, 2011	1,055	13,174	
Provision	859	6,658	
Write-offs and recoveries, net	(840	) (2,610	)
Balance at December 31, 2012	1,074	17,222	
Provision	404	11,652	
Write-offs and recoveries, net	(430	) (4,928	)
Balance at December 31, 2013	\$ 1,048	\$ 23,946	

(1) The provision is included in selling expenses.

(2) The provision is included in cost of revenues.