Alphatec Holdings, Inc.
Form 10-Q
November 04, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2011

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	**20-2463898**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

5818 El Camino Real

Carlsbad, CA 92008

(Address of principal executive offices, including zip code)

(760) 431-9286

(Registrant s telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x No ¨

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

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

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

Yes ¨ No x

As of November 1, 2011, there were 89,246,590 shares of the registrant s common stock outstanding.

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ALPHATEC HOLDINGS, INC.

QUARTERLY REPORT ON FORM 10-Q

September 30, 2011

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

ALPHATEC HOLDINGS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

(In thousands, except for par value data)

	September 30, 2011	December 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	$ 22,144	$ 23,168
Accounts receivable, net	39,775	39,777
Inventories, net	48,783	51,635
Prepaid expenses and other current assets	7,145	6,652
Deferred income tax assets	1,592	1,592
Total current assets	119,439	122,824
Property and equipment, net	34,322	38,440
Goodwill	173,626	170,194
Intangibles, net	41,828	43,148
Other assets	3,475	2,410
Total assets	$ 372,690	$ 377,016
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 14,987	$ 15,957
Accrued expenses	23,229	22,530
Deferred revenue	3,351	3,396
Current portion of long-term debt	2,544	1,708
Total current liabilities	44,111	43,591
Long-term debt, less current portion	28,771	32,474
Other long-term liabilities	1,826	2,153
Deferred income tax liabilities	6,910	8,761
Redeemable preferred stock, $0.0001 par value; 20,000 authorized at September 30, 2011 and December 31, 2010; 3,319 shares issued and outstanding at both September 30, 2011 and December 31, 2010	23,603	23,603
Commitments and contingencies		
Stockholders equity:		
Common stock, $0.0001 par value; 200,000 authorized at September 30, 2011 and December 31, 2010; 89,241 and 89,040 shares issued and outstanding at September 30, 2011 and December 31, 2010, respectively	9	9
Treasury stock, 19 shares	(97)	(97)
Additional paid-in capital	385,601	383,647
Accumulated other comprehensive income (loss)	3,986	(1,310)
Accumulated deficit	(122,030)	(115,815)
Total stockholders equity	267,469	266,434

Total liabilities and stockholders equity	$ 372,690	$ 377,016

See accompanying notes to unaudited condensed consolidated financial statements.

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ALPHATEC HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

(in thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Revenues	$ 47,619	$ 44,846	$ 148,201	$ 125,592
Cost of revenues	17,001	15,546	54,959	43,516
Amortization of acquired intangible assets	411	373	1,223	742
Gross profit	30,207	28,927	92,019	81,334
Operating expenses:				
Research and development	3,858	3,751	13,653	12,347
In-process research and development		2,425		2,967
Sales and marketing	19,145	17,052	57,065	47,571
General and administrative	8,627	7,933	26,707	21,500
Amortization of acquired intangible assets	545	533	1,629	1,002
Transaction related expenses		6		3,651
Restructuring expenses	394	702	993	2,389
Total operating expenses	32,569	32,402	100,047	91,427
Operating loss	(2,362)	(3,475)	(8,028)	(10,093)
Other income (expense):				
Interest income	48	262	103	297
Interest expense	(725)	(1,417)	(2,292)	(3,722)
Other income, net	202	70	958	1,062
Total other income (expense)	(475)	(1,085)	(1,231)	(2,363)
Loss from continuing operations before taxes	(2,837)	(4,560)	(9,259)	(12,456)
Income tax benefit	(1,533)	(770)	(3,044)	(899)
Loss from continuing operations	(1,304)	(3,790)	(6,215)	(11,557)
Income from discontinued operations, net of tax				78
Net loss	$ (1,304)	$ (3,790)	$ (6,215)	$ (11,479)
Net loss per common share:				
Basic and diluted net loss per share from continuing operations	$ (0.01)	$ (0.04)	$ (0.07)	$ (0.15)
Basic and diluted net income per share from discontinued operations	0.00	0.00	0.00	0.00
Basic and diluted net loss per share	$ (0.01)	$ (0.04)	$ (0.07)	$ (0.15)
Weighted-average shares used in computing net loss per share:				
Basic and diluted	88,829	86,990	88,757	75,394

See accompanying notes to unaudited condensed consolidated financial statements.

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ALPHATEC HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

(in thousands)

	Nine Months Ended September 30, 2011	2010
Operating activities:		
Net loss	$ (6,215)	$ (11,479)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	14,939	12,451
Stock-based compensation	1,928	2,326
Interest expense related to amortization of debt discount and debt issuance costs	281	722
In-process research and development paid in stock		1,000
Provision for doubtful accounts	594	764
Provision for excess and obsolete inventory	3,365	1,839
Gain on sale of IMC Co. (discontinued operations)		(188)
Deferred income tax benefit	(2,352)	(1,101)
Changes in operating assets and liabilities:		
Accounts receivable	(1,919)	(5,145)
Inventories	(140)	(13,297)
Prepaid expenses and other current assets	474	(1,666)
Other assets	828	268
Accounts payable	995	(1,384)
Accrued expenses and other	(1,643)	888
Deferred revenues	(26)	849
Net cash provided by (used in) operating activities	11,109	(13,153)
Investing activities:		
Cash received in acquisition of Scient x		1,589
Proceeds from sale of IMC Co. (discontinued operations)		329
Cash paid for acquisition of Brazilian subsidiary	(620)	
Purchases of property and equipment	(8,033)	(11,657)
Purchase of intangible assets	(445)	(500)
Net cash used in investing activities	(9,098)	(10,239)
Financing activities:		
Exercise of stock options	104	211
Net proceeds from issuance of common stock		49,659
Borrowings under lines of credit	1,662	2,610
Repayments under lines of credit	(3,114)	(1,796)
Principal payments on capital lease obligations	(114)	(129)
Principal payments on notes payable	(1,523)	(7,273)
Net cash (used in) provided by financing activities	(2,985)	43,282
Effect of exchange rate changes on cash and cash equivalents	(50)	(1,121)
Net (decrease) increase in cash and cash equivalents	(1,024)	18,769
Cash and cash equivalents at beginning of period	23,168	10,085

Cash and cash equivalents at end of period	$	22,144	$	28,854

See accompanying notes to unaudited condensed consolidated financial statements.

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ALPHATEC HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

(UNAUDITED)

(in thousands)

	Nine Months Ended September 30,	
	2011	2010
Supplemental cash flow information:		
Cash paid for interest	$ 1,828	$ 2,460
Cash paid for income taxes	$ 303	$ 339
Purchases of property and equipment in accounts payable	$ 2,241	$ 3,765
Financing of software and support by third party	$ 121	$ 872
Financing of insurance premiums by insurance provider	$	$ 406
Non-cash purchases of license agreements	$ 50	$
Issuance of common stock in connection with Scient x acquisition	$	$ 151,639
Stock options issued in connection with Scient x acquisition	$	$ 1,040
Non-cash exercise of warrants	$	$ 540
Non-cash purchase of intangible assets	$	$ 1,500
Purchase of intangible assets in accrued expenses	$	$ 1,450

See accompanying notes to unaudited condensed consolidated financial statements.

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ALPHATEC HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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 in the U.S. 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 subsidiaries, Scient x S.A.S. and its subsidiaries (Scient x), and Alphatec Pacific, Inc. and its subsidiaries (Alphatec Pacific).

The Company acquired Scient x on March 26, 2010. Subsequent to the closing of the acquisition, the Company became responsible for managing the operation of the combined entities (See Note 3).

Basis of Presentation

The condensed consolidated financial statements include the accounts of Alphatec and Alphatec Spine and its wholly owned subsidiaries. The results of operations for the nine months ended September 30, 2010 do not include the results of Scient x for the first quarter of 2010 as the Company determined that Scient x s results of operations for the five days from the acquisition date, March 26, 2010, to the fiscal quarter end were immaterial to the Company s first quarter 2010 consolidated results. All intercompany balances and transactions have been eliminated in the condensed consolidated financial statements.

In April 2010, Alphatec Pacific entered into an agreement to sell its wholly owned subsidiary, IMC Co., to a third party. (see Note 13).

The accompanying condensed consolidated balance sheet as of December 31, 2010, which has been derived from audited financial statements, and the unaudited interim condensed consolidated financial statements have been prepared by the Company in accordance with U.S. generally accepted accounting principles (GAAP) and the rules and regulations of the Securities and Exchange Commission (SEC) related to a quarterly report on Form 10-Q. Certain information and note disclosures normally included in annual audited financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to those rules and regulations, although the Company believes that the disclosures made in this quarterly report on Form 10-Q are adequate to make the information not misleading. The unaudited interim condensed consolidated financial statements reflect all normal recurring adjustments which, in the opinion of management, are necessary for a fair statement of the financial position and results of operations for the periods presented. All such adjustments are of a normal and recurring nature. These unaudited condensed consolidated financial statements should be read in conjunction with the Company s audited financial statements for the year ended December 31, 2010, which are included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010 that was filed with the SEC on March 4, 2011.

Operating results for the three and nine months ended September 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011, or any other future periods.

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 and cash equivalents of $22.1 million and accounts receivable of $39.8 million at September 30, 2011 will be sufficient to fund its cash requirements through at least September 30, 2012. The Company s amended credit facility (the Amended Credit Facility) with Silicon Valley Bank (SVB) contains financial covenants consisting of a minimum adjusted quick ratio and minimum quarterly free cash flow. As of September 30, 2011, the Company was not in compliance with the minimum adjusted quick ratio covenant or the minimum quarterly free cash flow covenant. In November 2011, the Company and SVB executed an agreement for a third amendment to the Amended Credit Facility (the Third Amended Credit Facility). The Third Amended Credit Facility included a waiver for non-compliance with the financial covenants for the quarterly period ended September 30, 2011 and it also restructured the Amended Credit Facility terms including future financial covenants (see Note 7).

Based on the Company s current operating plan, the Company believes that it is reasonably likely that it will be in compliance with the financial covenants of the Third Amended Credit Facility in the foreseeable future. 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 growth 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 Third Amended Credit Facility. In addition to the financial covenants, the Third

Amended Credit Facility contains other covenants including subjective clauses that would allow the lender to declare the loan immediately due and payable. Upon the occurrence of a covenant violation or other event of default that is not waived, the lender could elect to declare all amounts outstanding under the Third Amended Credit Facility to be immediately due and payable and terminate all commitments to extend further credit. If the lender were to accelerate the repayment of borrowings under the Third Amended Credit Facility for any reason, the Company may not have sufficient cash on hand to repay the amounts borrowed under the Third Amended Credit Facility and would be forced to obtain alternative financing.

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If the Company is not able to achieve the minimum targeted revenue growth and related improvements in profitability to meet the quarterly covenants or has other unanticipated expenditures, the Company may be required to attempt to seek a waiver of such covenants, renegotiate the amended credit facility, and/or substantially reduce discretionary spending, which could have a material adverse effect on the Company s ability to achieve its intended business objectives. There can be no assurances that such a waiver could be obtained, that the Third Amended 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, the lender would have the right to exercise remedies specified in the Third Amended Credit Facility, including accelerating the repayment of debt obligations as discussed above. 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

The Company s significant accounting policies are described in Note 2 to its audited consolidated financial statements for the year ended December 31, 2010, which are included in the Company s Annual Report on Form 10-K that was filed with the SEC on March 4, 2011. Except as discussed below, these accounting policies have not significantly changed during the nine months ended September 30, 2011.

Impairment Analysis for Goodwill

The Company performs its test for goodwill impairment annually during the fourth quarter and in interim periods if certain events occur indicating that the carrying value of goodwill may be impaired. During the three months ended September 30, 2011, the Company concluded that a decline in its stock price and market capitalization was an indicator of a potential impairment in goodwill. As a result, the Company performed an interim impairment test on its single operating unit.

The goodwill impairment test is a two-step process. The first step compares the Company s fair value to its net book value. If the fair value is less than the net book value, the second step of the test compares the implied fair value of the Company s goodwill to its carrying amount. If the carrying amount of goodwill exceeds its implied fair value, the Company would recognize an impairment loss equal to that excess amount.

The Company estimated the fair value in step one based on the income approach which included discounted cash flows as well as a market approach that utilized the Company s earnings and revenue multiples and recent sales transactions. 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. The Company utilized its weighted average cost of capital as the discount rate for the projected future cash flows and its median revenue and earnings multiples under the market approach. The Company s assessment resulted in a fair value that was greater than the Company s carrying value at September 30, 2011. In accordance with the authoritative literature, the second step of the impairment test was not required to be performed and no impairment of goodwill was recorded as of September 30, 2011.

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. 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 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 three 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 may be required to perform a step two analysis that could expose the Company to material impairment charges in the future.

The Company will re-assess goodwill impairment when it performs its annual test for impairment in December 2011. The Company will also be required to perform additional interim analysis if its stock price and market capitalization do not increase above current levels.

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Recent Accounting Pronouncements

In September 2011, the Financial Accounting Standards Board (FASB) amended its goodwill guidance by providing entities an option to use a qualitative approach to test goodwill for impairment. An entity will be able to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If it is concluded that this is the case, it is necessary to perform the currently prescribed two-step goodwill impairment test. Otherwise, the two-step goodwill impairment test is not required. The amendment will be effective for the Company on January 1, 2012. The Company does not anticipate that this amendment will have a material impact on its financial position or results of operations.

In September 2011, the FASB issued new accounting guidance that requires total comprehensive income, the components of net income and the components of other comprehensive income to be presented either in a single continuous statement or in two separate but consecutive statements. This guidance will be effective for the Company in the fiscal year beginning January 1, 2012. The new guidance eliminates the current option to report other comprehensive income and its components in the statement of shareholders equity. While the new guidance changes the presentation of other comprehensive income, there are no changes to the components that are recognized in other comprehensive income. Other than presentation, the adoption of this guidance will not have an impact on the Company s financial position or results of operations.

3. Acquisitions

Purchase of Scient x

On December 17, 2009, the Company entered into an acquisition agreement to acquire all of the shares of Scient x, with Scient x continuing after the acquisition as a wholly-owned subsidiary of the Company s newly formed and wholly owned Dutch subsidiary. The acquisition, which closed on March 26, 2010, is accounted for under the acquisition method of accounting. The effective acquisition date for accounting purposes was the close of business on March 31, 2010, the end of Scient x s fiscal first quarter. The Company purchased Scient x to acquire Scient x s product portfolio and technology, its international distribution network and existing customer base, and because of the increased scale of the combined entities.

The transaction was structured as an all stock transaction such that all of the outstanding stock of Scient x was exchanged, pursuant to a fixed ratio, for 24,000,000 shares of the Company s common stock. The shares to be paid by the Company at the closing were reduced to 23,730,644 shares in exchange for the Company paying certain acquisition fees and expenses incurred by HealthPointCapital Partners, L.P. and HealthPointCapital Partners II, L.P. (collectively, HealthPointCapital), the Company s and Scient x s principal stockholders.

As required by the acquisition agreement, the holders of both vested and unvested options to purchase shares of Scient x common stock who were employed by either Scient x or Alphatec on the closing date were entitled to receive replacement options to purchase shares of Alphatec common stock upon closing of the acquisition (Replacement Options), and such optionees were given credit for the vesting of their Scient x options up to the closing date. $1.0 million was included in the purchase price to represent the fair value of the Scient x options attributable to pre-combination service and was estimated using the Black-Scholes-Merton option pricing model with market assumptions. Option pricing models require the use of highly subjective market assumptions, including expected stock price volatility, which if changed can materially affect fair value estimates. The assumptions used in estimating the fair value of the Replacement Options include expected volatility of 56.0%, expected term of 6.0 years, and a risk-free interest rate of 2.5%. The difference between the total fair value of the Replacement Options and the fair value of $1.0 million attributable to pre-combination service is being recognized as compensation cost in the Company s post-combination financial statements over the requisite service period.

Based on the closing price of Alphatec s common stock of $6.39 on March 26, 2010, the fair value of the Replacement Options, and the amount payable in exchange for reduction in shares, the total purchase price was as follows (in thousands):

Fair value of Alphatec common stock issued upon closing	$ 151,639
Fair value of Scient x Replacement Options attributable to pre-combination service	1,040
Payable in exchange for reduction in shares to be paid in cash	1,618
Total purchase price	$ 154,297

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

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

	Useful lives (in years)	Estimated Fair Value
Net tangible assets assumed		$ 2,577
Acquired intangibles:		
Core technology	10	3,632
Developed technology	8	9,552
In-process technology	Indefinite	1,749
Corporate trademarks	5	1,614
Key product trademarks	9	2,179
Customer-related intangible	15	16,009
Distribution network	10	1,614
Physician education programs	10	3,095
Goodwill		112,276
Total purchase price allocation		$ 154,297

The Company allocated $2.6 million to Scient x net tangible assets assumed and $39.4 million to identifiable intangible assets acquired. A value of $112.3 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 assumed, was assigned to goodwill. Alphatec acquired Scient x to expand its product offerings, increase its addressable market, increase the size of its international business, and increase its revenues primarily outside of the U.S. Alphatec also believes that significant cost reduction synergies may be realized when the integration of the acquired business is complete. These are among the factors that contributed to a purchase price for the Scient x acquisition that resulted in the recognition of goodwill. The amount recorded as acquired intangibles and goodwill is not expected to be deductible for tax purposes.

The Company increased the value of inventory it acquired from Scient x 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 14 months and was included in the Company s post-combination financial statements. The increase to inventory was offset by a decrease in estimated fair value of redundant inventory based on the highest and best use of a similar market participant.

For the technology-related assets, the Company separated the acquired product families into the following three categories: core, developed, and in-process technology. 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 separated trademarks into the following two categories: corporate trademarks and key product trademarks. The Company calculated the values of each of these trademark categories 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 customer-related intangible includes hospitals and distributors that take title to Scient x 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 Scient x 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.

The Company determined the value of physician education programs value by estimating the costs to rebuild such programs.

The fair value of the non-controlling interest as of March 26, 2010 was $0.5 million and was determined by reviewing the fair value of Scient x s Italian subsidiary s net equity and multiplying such amount by 30%, which represents the ownership interest of the non-controlling party.

Scient x is subject to legal and regulatory requirements, including but not limited to those related to taxation in each of the jurisdictions in which it operates. The Company has conducted an assessment of liabilities arising from these tax matters in each of such jurisdictions, and has

recognized provisional amounts in its accounting for the acquisition of Scient x for the identified liabilities.

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The changes in the carrying amount of goodwill since the acquisition date through September 30, 2011 were as follows (in thousands):

Goodwill recorded for Scient x acquisition as of March 31, 2010	$ 112,524
Cumulative purchase price adjustments to net tangible assets	(248)
Net effect of foreign exchange rate on goodwill	1,096
Balance at September 30, 2011	$ 113,372

The following unaudited pro forma information presents the consolidated results of operations of the Company and Scient x as if the acquisition had occurred on January 1, 2010 (in thousands, except share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Revenues	$ 47,619	$ 44,846	$ 148,201	$ 136,927
Loss from operations	(1,968)	(2,767)	(7,035)	(5,209)
Net loss	(910)	(3,082)	(5,222)	(5,922)
Net loss per share, basic and diluted	$ (0.01)	$ (0.04)	$ (0.06)	$ (0.07)

The pro forma information is not necessarily indicative of what the results of operations actually would have been had the acquisition been completed on the date indicated. In addition, it does not purport to project the future operating results of the combined entity. The pro forma condensed combined financial information is presented for illustrative purposes only and does not reflect the realization of potential cost savings, revenue synergies or any restructuring costs.

For the three months ended September 30, 2011 and 2010 and the nine months ended September 30, 2011, the Company did not incur any transaction costs related to the acquisition. For the nine months ended September 30, 2010, the Company incurred transaction costs related to the acquisition of $3.7 million. These costs were expensed as incurred.

For the three months ended September 30, 2011 and 2010, the Company incurred restructuring charges related to the acquisition of $0.4 million and $0.7 million, respectively. For the nine months ended September 30, 2011 and 2010, the Company incurred restructuring charges related to the acquisition of $1.0 million and $2.4 million, respectively. These restructuring charges consist of severance payments and severance-related benefits, rent and other expenses for facilities and the cost of exiting two terminated European distributor agreements.

The amount of Scient x revenue included in the Company s condensed consolidated statement of operations for the three months ended September 30, 2011 and 2010 totaled $6.6 million and $8.2 million, respectively. The amount of Scient x net loss included in the Company s condensed consolidated statement of operations for the three months ended September 30, 2011 and 2010 totaled $(2.0) million and $(3.3) million, respectively.

In future periods, the combined business may incur charges to operations that reflect costs associated with integrating the two businesses. The Company cannot reasonably estimate such costs at this time.

Purchase of Minority Interest

During December 2010, Scient x acquired the non-controlling interest of its Italian subsidiary from the non-controlling party for $0.5 million. The fair value of the non-controlling interest as of the repurchase date was $0.5 million.

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 $0.8 million, which includes $0.2 million related to the deferred tax impact from the acquisition, for the ANVISA regulatory registration certificates and licenses it purchased to conduct business in Brazil. 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. As of September 30, 2011, the Company had paid the full purchase price of $0.6 million.

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4. Select Balance Sheet Details

Inventories

Inventories consist of the following (in thousands):

	September 30, 2011			December 31, 2010		
	Gross	Reserve for excess and obsolete	Net	Gross	Reserve for excess and obsolete	Net
Raw materials	$ 3,476	$	$ 3,476	$ 3,821	$	$ 3,821
Work-in-process	2,465		2,465	2,242		2,242
Finished goods	54,832	(11,990)	42,842	56,602	(11,030)	45,572
Inventories, net	$ 60,773	$ (11,990)	$ 48,783	$ 62,665	$ (11,030)	$ 51,635

Property and Equipment

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

	Useful lives (in years)	September 30, 2011	December 31, 2010
Surgical instruments	4	$ 56,279	$ 53,155
All other property and equipment	various	23,791	22,450
		80,070	75,605
Less accumulated depreciation and amortization		(45,748)	(37,165)
Property and equipment, net		$ 34,322	$ 38,440

Total depreciation expense was $3.7 million and $3.6 million for the three months ended September 30, 2011 and 2010, respectively. Total depreciation expense was $11.1 million and $9.5 million for the nine months ended September 30, 2011 and 2010, respectively.

Intangible Assets

Intangible assets consist of the following (in thousands except as indicated):

	Useful lives (in years)	September 30, 2011	December 31, 2010
Developed product technology	5-8	$ 23,352	$ 23,030
Distribution rights	3	4,313	4,148
Intellectual property	5	1,004	1,004
License agreements	1-7	6,487	5,100
Core technology	10	3,670	3,548
In-process technology	Indefinite	1,767	1,708
Trademarks and trade names	5-9	3,827	3,722
Customer-related	15	16,160	15,792
Distribution network	10	1,614	1,614
Physician education programs	10	3,127	3,022

Supply agreement	10	225	225
		65,546	62,913
Less accumulated amortization		(23,718)	(19,765)
Intangible assets, net		$ 41,828	$ 43,148

Total amortization expense was $1.3 million and $1.0 million for the three months ended September 30, 2011 and 2010, respectively. Total amortization expense was $3.8 million and $3.0 million for the nine months ended September 30, 2011 and 2010, respectively.

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The future expected amortization expense related to intangible assets as of September 30, 2011 is as follows (in thousands):

Year Ending December 31,	
Remainder of 2011	$ 1,110
2012	4,440
2013	4,394
2014	4,291
2015	4,139
Thereafter	21,687
Total future expected amortization expense	40,061
Add: In-process technology	1,767
Total	$ 41,828

5. Comprehensive Income (Loss)

Comprehensive income (loss) is defined as the change in equity of a business enterprise during a period from transactions and other events, including foreign currency translation adjustments. The following table sets forth the computation of comprehensive income (loss) for the three and nine months ended September 30, 2011 and 2010 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net loss, as reported	$ (1,304)	$ (3,790)	$ (6,215)	$ (11,479)
Foreign currency translation adjustment	(6,980)	14,118	5,296	544
Comprehensive (loss) income	$ (8,284)	$ 10,328	$ (919)	$ (10,935)

The change in cumulative foreign currency translation adjustment primarily relates to the Company s investment in Scient x and fluctuations in exchange rates between Scient x s local currency (the Euro) and the U.S. dollar. During the three and nine months ended September 30, 2011, the change in the foreign currency translation amounts resulted from changes in the value of the Euro. The value of the Euro decreased approximately 5% relative to the U.S. dollar during the three months ended September 30, 2011 and increased approximately 9% relative to the U.S. dollar during the three months ended September 30, 2010. The value of the Euro increased approximately 3% relative to the U.S. dollar during the nine months ended September 30, 2011 and decreased approximately 6% relative to the U.S. dollar during the nine months ended September 30, 2010.

6. License and Developmental Consulting Agreements

The Company s license and developmental consulting agreements are described in Note 5 to its audited consolidated financial statements for the year ended December 31, 2010, which are included in its Annual Report on Form 10-K which was filed with the SEC on March 4, 2011. The description below is a supplement to such description in the Form 10-K.

License Agreement with Vertebration, Inc.

In March 2011, the Company entered into a License Agreement (the Vertebration Agreement) with Vertebration, Inc. (Vertebration) that provides the Company with an exclusive license to develop and commercialize Vertebration s proprietary licensed technology related to its Xycor implant and related instrumentation. The Xycor implant has received 510(k) approval for marketing by the United States Food and Drug Administration (the FDA). The financial terms of the Vertebration License Agreement include: (i) a cash payment of $0.5 million following the execution of the Vertebration License Agreement, of which $0.1 million will be credited against amounts payable to Vertebration at a future date and $0.1 million will be repaid by Vertebration in March 2014; (ii) additional cash payments totaling $0.2 million payable in 2011;

(iii) development and sales milestone payments in cash that could begin to be achieved and paid in 2012; and (iv) payments consisting of either: (a) a royalty based on net sales of licensed products or (b) a payment of percentage of the Company s gross margin, with the type of payment dependent on the manner in which the product was sold, with minimum annual payments beginning in the year after the first commercial sale of a licensed product. During the first quarter of 2011, the Company recorded an intangible asset of $0.4 million following the execution of the Vertebration License Agreement. The Company is amortizing this asset over seven years, the estimated life of the Xycor product.

7. Debt

As of September 30, 2011, the Company had an Amended Credit Facility with SVB that consisted of a working capital line of credit, which permitted the Company to borrow up to $32 million. The actual amount available is based on eligible accounts receivable and eligible inventory. The working capital line of credit carries an interest rate equal to the greater of 5.5% or the SVB prime rate plus 2.0%. Interest-only payments are due monthly and the principal is due at maturity, which occurs in October 2013. The Amended Credit Facility contains financial covenants consisting of a minimum adjusted quick ratio and minimum quarterly free cash flow. The minimum adjusted quick ratio is defined as the sum of the Company s cash held with SVB and 80% of eligible domestic accounts receivable divided by the Amended Credit Facility balance. Free cash flow is defined as Adjusted EBITDA (a non-GAAP term defined as 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 and restructuring expenses), less capital expenditures and cash taxes.

As of September 30, 2011, the Company was not in compliance with the minimum adjusted quick ratio covenant or the minimum quarterly free cash flow covenant. In November 2011, the Company and Silicon Valley Bank executed the Third Amended Credit Facility. The Third Amended Credit Facility included a waiver for non-compliance with the minimum quarterly financial covenants for the quarterly period ended September 30, 2011 and it also restructured the credit facility terms including future financial covenants.

The Third Amended Credit Facility consists of a $10 million term loan and a working capital line of credit which permits the Company to borrow up to $22 million. The actual amount available under the line of credit is based on eligible accounts receivable and eligible inventory. The term loan carries a fixed interest rate equal to the SVB prime rate plus 4.5% with principal plus interest repayments due in 16 equal quarterly installments. A finance charge of $100,000 is waived in exchange for the issuance of warrants to SVB to purchase shares of the Company s common stock. The term loan matures October 2015 and the Company will pay a prepayment penalty if the term loan is repaid prior to maturity. The funds from the term loan were intended to refinance a portion of the line of credit under the Amended Credit Facility. The working capital line of credit carries an interest rate equal to the SVB prime rate plus 3.5%, with calculated minimum monthly interest of $116,000. Interest only payments are due monthly and the principal is due at maturity, October 2013, which is consistent with the amended credit facility. A finance charge of $50,000 is waived in exchange for the issuance of warrants to SVB to purchase shares of the Company s common stock.

Under the Third Amended Credit Facility, the Company is required to maintain compliance with financial covenants consisting of a quarterly minimum adjusted quick ratio and a quarterly minimum EBITDA level, as well as a maximum annual capital expenditures limit. The minimum adjust quick ratio is defined as the sum of the Company s cash held with SVB and 80% of eligible domestic accounts receivable divided by the total balance of debt owed to SVB. EBITDA, a non-GAAP term, is defined as 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 and restructuring expenses.

The remaining terms under the Third Amended Credit Facility were not amended from the Amended Credit Facility.

The balance of the line of credit as of September 30, 2011 was $30.4 million. However, based on the future commitments under the Third Amended Credit Facility the Company has reclassified $1.9 million of term loan principal payments from long-term debt to current portion of long-term debt as of September 30, 2011.

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8. Commitments and Contingencies

Leases

The Company leases certain equipment under capital leases which expire on various dates through 2014. The Company and Scient x also lease their buildings and certain equipment and vehicles under operating leases which expire on various dates through 2017. Future minimum annual lease payments under such leases are as follows (in thousands):

Year Ending December 31,	Operating	Capital
Remainder of 2011	$ 982	$ 46
2012	3,717	178
2013	3,191	60
2014	2,811	1
2015	2,251	
Thereafter	1,276	
	$ 14,228	285
Less: amount representing interest		(8)
Present value of minimum lease payments		277
Current portion of capital leases		(169)
Capital leases, less current portion		$ 108

Rent expense under operating leases for the three months ended September 30, 2011 and 2010 was $1.0 million and $0.8 million, respectively. Rent expense under operating leases for the nine months ended September 30, 2011 and 2010 was $2.8 million and $2.3 million, respectively.

Litigation

In January 2011, the Company filed a complaint in the U.S. District Court for the Southern District of California against Biomet, Inc., alleging that Biomet s TPS-TL products infringe one of the Company s patents. The Company is seeking money damages, attorneys fees and interest. The outcome of the litigation cannot be predicted at this time and there can be no assurance that the Company will be successful in its claims.

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, (Cross), *Cross Medical Products, LLC v. Alphatec Spine, Inc.,* Case No. 8:10-cv-00176-MRP -MLG, alleging that the Company breached a patent license agreement with Cross by failing to make certain royalty payments allegedly due under the agreement. Cross is 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 the Company. In its complaint, Cross alleges a material amount of damages are due to it as a result of the Company s alleged breach of the patent license agreement. The Company denied the allegations in its answer to the complaint and intends to vigorously defend itself against the complaint. In February 2011 and July 2011, the court issued orders granting Cross s motions for partial summary judgment, and limiting the Company s counterclaims. The court rulings interpreted the license agreement as asserted by Cross, and found that the license agreement, as so interpreted, is enforceable. The Company intends to appeal the trial court s decisions. A trial to determine which products are subject to the patent license agreement, and therefore under the interpretation of the trial court subject to royalty payment, is currently scheduled for February 2012. The Company believes the damages are not currently estimable, as discovery with respect to this phase of the trial is still ongoing, but a judgment for damages in favor of Cross would have a material adverse effect on the Company s results of operations, financial condition and cash flows.

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, or Orthotec. In 2004, Orthotec sued Eurosurgical in connection with a contractual dispute and a $9 million judgment was entered against Eurosurgical by a California court. At the same time, 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 approved by a French court.

Pursuant to this sale, Surgiview became a subsidiary of Scient x

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in 2006. Orthotec attempted to recover on Eurosurgical s obligations in California and federal courts 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 May 2008, after the acquisition of Scient x by HealthpointCapital in 2007, Orthotec sued Scient x, Surgiview, HealthpointCapital and certain Scient x directors (who also serve on our board) in a new action in California state court. In addition, at the same time, a similar action was filed in New York against HealthpointCapital and two directors of Scient x (who also serve on our board). In April 2009, the California court dismissed this matter on jurisdictional grounds, and Orthotec appealed such ruling. In December 2010, the California Court of Appeal issued a decision that affirmed in part and reversed in part the trial court s decision dismissing the entire California action based on lack of personal jurisdiction. The Court of Appeal affirmed the trial court s ruling that Orthotec failed to establish personal jurisdiction over all parties except Surgiview, finding that the trial court could exercise jurisdiction over that entity. In November 2009, the New York court dismissed Orthotec s claims based on collateral estoppel, and Orthotec appealed this ruling. In March 2011, the state appeals court in NY reversed the lower court s decision to dismiss Orthotec s claims, and the New York matter is proceeding with HealthpointCapital and certain Scient x directors (who also serve on our board) as the only defendants. While the Company intends to vigorously defend against the complaint, and believes that the plaintiff s allegations are without merit, the outcome of the litigation cannot be predicted at this time and any outcome in favor of Orthotec could have a significant adverse effect on the Company s financial condition and results of operations.

In 2004, Scient x s wholly owned U.S. subsidiary, Scient x USA, Inc. (Scient x USA), entered into a distribution agreement with DAK Surgical, Inc. and DAK Spine, Inc., two independent distributors (collectively DAK), for the distribution of products in certain defined sales areas. In September 2007, shortly after the expiration of the distribution contract, DAK, and their principals filed a lawsuit in Florida state court against Scient x USA and Scient x in which they alleged, among other things, that (i) Scient x USA breached the distribution agreement, (ii) Scient x USA interfered with DAK s business relationships, and (iii) personnel at Scient x USA made defamatory remarks regarding the principals of DAK. In February 2011, the court granted Scient x USA s Partial Motion for Summary Judgment finding that there was no obligation for Scient x USA or Scient x to pay DAK under a change of ownership clause in the distribution agreement with DAK. While the Company intends to vigorously defend itself against the complaint, and believes that the plaintiff s remaining allegations are also without merit, the outcome of the litigation cannot be predicted at this time and any outcome in favor of DAK could have a significant adverse effect on the Company s financial condition and results of operations.

In August 2009, a complaint filed under the qui tam provisions of the United States Federal False Claims Act (the FCA) that had been filed by private parties against Scient x USA was unsealed by the United States District Court for the Middle District of Florida (Hudak v. Scient x USA, Inc., et al. (Civil Action No. 6:08-cv-1556-Orl-22DAB, U.S. District Court, W.D. Florida). The complaint alleged violations of the FCA arising from allegations that Scient x USA engaged in improper activities related to consulting payments to surgeon customers. The relators in the complaint were the principals of the plaintiff in the DAK Surgical matter discussed above. Under the FCA, the United States Department of Justice, Civil Division, (DOJ), had a certain period of time in which to decide whether to intervene and conduct the action against Scient x, or to decline to intervene and allow the private plaintiffs to proceed with the case. In August 2009, the DOJ filed a notice informing the court that it was declining to intervene in the case. In December 2009, the private plaintiffs who filed the action moved the court to dismiss the matter without prejudice, the Attorney General consented to such dismissal and the matter was dismissed without prejudice. Despite the dismissal of this matter, the DOJ is continuing its review of the facts alleged by the original plaintiffs in this matter. To date, neither the Company nor Scient x USA have been subpoenaed by any governmental agency in connection with this review. The Company believes that Scient x USA s business practices were in compliance with the FCA and intends to vigorously defend itself with respect to the allegations contained in the qui tam complaint, however, the outcome of the matter cannot be predicted at this time and any adverse outcome could have a significant adverse effect on the Company s financial condition and results of operations.

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 us and certain of its directors and executives alleging violations of the Securities Exchange Act of 1934, as amended, and Rule 10b-5 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. 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 the Company s financial guidance following the closing of the acquisition. The complaint seeks unspecified monetary damages, attorneys fees, and other unspecified relief. The Company believes the claims are without merit and intends to vigorously defend itself against this complaint; however no assurances can be given as to the timing or outcome of this lawsuit.

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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. 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. This consolidated lawsuit has been stayed by order of the court until August 26, 2012. The Company believes the claims are without merit and intends to vigorously defend itself against these complaints; however no assurances can be given as to the timing or outcome of this lawsuit.

At September 30, 2011, 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 condensed consolidated statement of operations as a component of cost of revenues.

9. 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 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):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Numerator:				
Loss from continuing operations	$ (1,304)	$ (3,790)	$ (6,215)	$ (11,557)
Income from discontinued operations, net of tax				78
Net loss	$ (1,304)	$ (3,790)	$ (6,215)	$ (11,479)
Denominator:				
Weighted average common shares outstanding	89,219	87,389	89,120	75,880
Weighted average unvested common shares subject to repurchase	(390)	(399)	(363)	(486)
Weighted average common shares outstanding basic	88,829	86,990	88,757	75,394
Effect of dilutive securities:				
Options, warrants and restricted share awards				
Weighted average common shares outstanding diluted	88,829	86,990	88,757	75,394

Net loss per common share:				
Basic and diluted net loss per share from continuing operations	$ (0.01)	$ (0.04)	$ (0.07)	$ (0.15)
Basic and diluted net income per share from discontinued operations	0.00	0.00	0.00	0.00
Basic and diluted net loss per share	$ (0.01)	$ (0.04)	$ (0.07)	$ (0.15)

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Options to purchase common stock	4,381	3,514	4,210	2,216
Unvested restricted share awards	390	399	363	486
Total	4,771	3,913	4,573	2,702

10. Income Taxes

To calculate its interim tax provision, at the end of each interim period the Company estimates the annual effective tax rate and applies that to its ordinary quarterly earnings. In addition, the effect of changes in enacted tax laws or rates or tax status is recognized in the interim period in which the change occurs. The computation of the annual estimated effective tax rate at each interim period requires certain estimates and significant judgment including, but not limited to, the expected operating income for the year, projections of the proportion of income earned and taxed in foreign jurisdictions, permanent and temporary differences between book and tax amounts, and the likelihood of recovering deferred tax assets generated in the current year. The accounting estimates used to compute the provision for income taxes may change as new events occur, additional information is obtained or as the tax environment changes.

The Company recognizes interest and penalties related to uncertain tax positions as a component of the income tax provision. The Company s unrecognized tax benefits decreased $0.8 million during the three months ended September 30, 2011. The decrease in unrecognized tax benefits during the three months ended September 30, 2011 was primarily related to an income tax settlement with the French authorities of approximately $0.8 million, offset by an increase related to federal and state research credits. The unrecognized tax benefits at September 30, 2011 were $4.0 million. With the facts and circumstances currently available to the Company, it is reasonably possible that there will be no change in the Company s unrecognized tax benefits within the next 12 months.

The income tax benefit consists primarily of income tax benefits related to the 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.

The Company is not currently under examination by the IRS or U.S. state and local authorities.

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 has one operating and one reportable business segment.

During the three and nine months ended September 30, 2011 and 2010, 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 segment, sales in Japan for the three months ended September 30, 2011 and 2010 totaled $6.5 million and $4.7 million, respectively, which represented greater than 10 percent of the Company s consolidated revenues for the respective periods. For the nine months ended September 30, 2011 sales in Japan totaled $17.6 million which represented greater than 10 percent of the Company s consolidated revenues for such period. For the nine months ended September 30, 2010, 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):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
United States	$ 32,674	$ 30,010	$ 101,073	$ 87,763

International	14,945	14,836	47,128	37,829
Total consolidated revenues	$ 47,619	$ 44,846	$ 148,201	$ 125,592

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

	September 30, 2011	December 31, 2010
United States	$ 197,014	$ 208,175
International	175,676	168,841
Total consolidated assets	$ 372,690	$ 377,016

12. Related Party Transactions

Dr. Stephen H. Hochschuler serves as a director of the Company s and Alphatec Spine s board of directors and Chairman of Alphatec Spine s Scientific Advisory Board. The Company, Alphatec Spine and Dr. Hochschuler entered into a consulting agreement on October 13, 2006 (the Consulting Agreement). Pursuant to the Consulting Agreement, Dr. Hochschuler is required to provide advisory services related to the spinal implant industry and the Company s research and development strategies. For the three and nine months ended September 30, 2011 and 2010, the Company incurred costs of $60,000 in each quarter for advisory services provided by Dr. Hochschuler.

13. Discontinued Operations and Restructuring Activities

Discontinued Operations

In connection with the Company s strategy to focus on the sale of spinal implants in Japan, Alphatec Pacific entered into an agreement to sell one of its wholly owned subsidiaries, IMC Co., to a third party in April 2010. The Company determined that IMC Co. was a non-strategic asset given that it is a distribution company that primarily sells general orthopedic trauma products in a limited geographic market. In exchange for all of the shares of IMC Co., the purchaser agreed to pay the Company a total purchase price of $0.5 million, of which $0.3 million was paid during the second quarter of 2010, and the remaining $0.2 million will be paid thereafter in three annual installments. A gain of $0.2 million was recorded on the sale of IMC Co. by the Company during the second quarter of 2010.

The amount of IMC Co. revenue and pretax income reported in discontinued operations for the three and nine months ended September 30, 2010 is as follows (in thousands):

	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2010
Revenue	$	$ 3,109
Income from continuing operations before income taxes	$	$ 120
Income tax provision		42
Income from discontinued operations, net of tax	$	$ 78

Restructuring Activities

As a result of the acquisition of Scient x, the Company elected to consolidate Scient x s operations in the United States, close its United States facility and move its operations to the Company s corporate location in Carlsbad, California. This consolidation was completed by April 30, 2010. Restructuring expenses also consist of severance and other personnel costs related to the reorganization of the Company s management.

The changes in the restructuring liability for the three months ended September 30, 2011 is as follows (in thousands):

Restructuring liability as of June 30, 2011	$ 298
Additional severance and personnel costs incurred	399
Less: restructuring related payments made during the three months ended September 30, 2011	(376)
Restructuring liability as of September 30, 2011	$ 321

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14. Subsequent Events

Debt Agreement

In November 2011, the Company and SVB executed an agreement for the Third Amended Credit Facility. The Third Amended Credit Facility included a waiver for non-compliance with the minimum quarterly financial covenants for the quarterly period ended September 30, 2011 and it also restructured the credit facility terms including future financial covenants (see Note 7).

Execution of Lease

In October 2011, the Company executed a lease agreement for machinery with a value of $0.6 million. The term of the lease is 60 months. Upon execution of the lease, the Company made an advance payment of $50,000.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

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, such as those set forth in Item 1A Risk Factors in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K for the year ending December 31, 2010, as well as any updates to those risk factors filed from time to time in our Quarterly Reports on Form 10-Q or Current Reports on Form 8-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, with a focus on products that treat conditions that affect the aging spine. 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 procedures such as vertebral compression fracture, disorders related to poor bone quality, spinal stenosis and minimally invasive access techniques. Our principal product offerings are focused on the global market for orthopedic spinal disorder solution products, which was estimated to have been more than $9.0 billion in revenue in 2010 and is expected to grow between 3%-4% over the next year. Our surgeons culture emphasizes 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. Our products and systems are made of titanium, titanium alloy, stainless steel, cobalt chrome, ceramic, and a strong, heat resistant, radiolucent, biocompatible plastic called polyetheretherketone, or PEEK. We also sell products made of allograft, which is human tissue that surgeons can use in place of metal and PEEK. We also sell bone-grafting products that are comprised of both human tissue and synthetic materials. 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 spine disorders. All of our implants that are sold in the U.S. that require U.S. Food and Drug Administration, or FDA, clearance have been cleared by the FDA.

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 or surgical centers. In general, except for those countries where we have a direct sales force (Japan, France, and the United Kingdom), we use independent distributors that purchase our products and market them to their surgeon customers. A majority of our business is conducted with customers within markets in which we have experience and with payment terms that are customary. If we offer payment terms greater than our customary business terms or begin operating in a new market, revenues are deferred until the sooner 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, depreciation of our surgical instruments, and the amortization of purchased intangibles. We manufacture substantially all of the non-allograft 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 expense. 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 expense, 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. At the time of acquisition, we expect all acquired IPR&D will reach technological feasibility, 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.

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

Transaction-related expense. Transaction-related expense consists of legal, accounting and financial advisory fees associated with the acquisition of Scient x.

Restructuring expense. Restructuring expense consists of severance and other personnel costs connected to the reorganization of the Company s management and those costs associated with exit or disposal activities related to the acquisition of Scient x.

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 (benefit) provision. Income tax (benefit) provision consists primarily of income tax benefits related to the 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 goodwill.

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 assumption conditions.

Critical accounting policies are those that, in management s view, are most important in the portrayal of our financial condition and results of operations. Except as discussed below, management believes there have been no material changes during the nine months ended September 30, 2011 to the critical accounting policies discussed in the Management s Discussion and Analysis of Financial Condition and Results of Operations section of our Annual Report on Form 10-K for the year ended December 31, 2010.

Impairment Analysis for Goodwill

We perform our test for goodwill impairment annually during the fourth quarter and in interim periods if certain events occur indicating that the carrying value of goodwill may be impaired. During the three months ended September 30, 2011, we concluded that a decline in our stock price and market capitalization was an indicator of a potential impairment in goodwill. As a result, we performed an interim impairment test on our single operating unit.

The goodwill impairment test is a two-step process. The first step compares our fair value to our net book value. If the fair value is less than the net book value, the second step of the test compares the implied fair value of our goodwill to our carrying amount. If the carrying amount of goodwill exceeds its implied fair value, we would recognize an impairment loss equal to that excess amount.

We estimated the fair value in step one based on the income approach which included discounted cash flows as well as a market approach that utilized our earnings and revenue multiples and recent sales transactions. 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. We utilized our weighted average cost of capital as the discount rate for the projected future cash flows and our median revenue and earnings multiples under the market approach. Our assessment resulted in a fair value that was greater than our carrying value at September 30, 2011. In accordance with the authoritative literature, the second step of the impairment test was not required to be performed and no impairment of goodwill was recorded as of September 30, 2011.

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. 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 as a result of our 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 three years. Although we believe our underlying assumptions supporting this assessment are

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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 may be required to perform a step two analysis that could expose us to material impairment charges in the future.

We will re-assess goodwill impairment when we perform our annual test for impairment in December 2011. We will also be required to perform additional interim analysis if our stock price and market capitalization do not increase above current levels.

Results of Operations

The table below sets forth certain statements of operations data for the periods indicated. Our historical results are not necessarily indicative of the operating results that may be expected in the future. The results of operations for the nine months ended September 30, 2010 do not include the results of Scient x for the first quarter 2010 as the acquisition closed on March 26, 2010. (See Note 3 to the condensed consolidated financial statements).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Revenues	$ 47,619	$ 44,846	$ 148,201	$ 125,592
Cost of revenues	17,001	15,546	54,959	43,516
Amortization of acquired intangible assets	411	373	1,223	742
Gross profit	30,207	28,927	92,019	81,334
Operating expenses:				
Research and development	3,858	3,751	13,653	12,347
In-process research and development		2,425		2,967
Sales and marketing	19,145	17,052	57,065	47,571
General and administrative	8,627	7,933	26,707	21,500
Amortization of acquired intangible assets	545	533	1,629	1,002
Transaction related expenses		6		3,651
Restructuring expenses	394	702	993	2,389
Total operating expenses	32,569	32,402	100,047	91,427
Operating loss	(2,362)	(3,475)	(8,028)	(10,093)
Other income (expense):				
Interest income	48	262	103	297
Interest expense	(725)	(1,417)	(2,292)	(3,722)
Other income, net	202	70	958	1,062
Total other income (expense)	(475)	(1,085)	(1,231)	(2,363)
Loss from continuing operations before taxes	(2,837)	(4,560)	(9,259)	(12,456)
Income tax benefit	(1,533)	(770)	(3,044)	(899)
Loss from continuing operations	(1,304)	(3,790)	(6,215)	(11,557)
Income from discontinued operations, net of tax				78
Net loss	$ (1,304)	$ (3,790)	$ (6,215)	$ (11,479)

Three Months Ended September 30, 2011 Compared to the Three Months Ended September 30, 2010

Revenues. Revenues were $47.6 million for the three months ended September 30, 2011 compared to $44.8 million for the three months ended September 30, 2010, representing growth of $2.8 million, or 6.2%. The increase was comprised of $2.7 million and $0.1 million of sales in the

U.S. and International regions, respectively.

U.S. revenues were $32.7 million for the three months ended September 30, 2011 compared to $30.0 million for the three months ended September 30, 2010, representing growth of $2.7 million, or 8.9%. The growth was primarily due to increased sales in Alphatec products of $2.7 million from implants and instruments ($1.7 million) and Biologics ($1.0 million), while sales of Scient x products remained consistent.

International revenues were $14.9 million for the three months ended September 30, 2011 compared to $14.8 million for the three months ended September 30, 2010, representing growth of $0.1 million, or 0.7%. The growth was due to increased sales of Alphatec products of $2.5 million, offset by a decrease in sales of Scient x products of $2.4 million. The increase in revenues is inclusive of $1.3 million in favorable exchange rate effect.

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Cost of revenues. Cost of revenues was $17.0 million for the three months ended September 30, 2011 compared to $15.5 million for the three months ended September 30, 2010, representing an increase of $1.5 million, or 9.4%. The increase was the result of greater costs for Alphatec products due to growth in sales and variation in product mix ($0.8 million), unfavorable manufacturing and absorption variances related to production volume and operational costs ($2.7 million), increase amortization expense related to acquired technology ($0.2 million), offset by a reduction in inventory step-up expense related to the Scient x acquisition of ($0.4 million), and lesser product costs due to reduced Scient x sales ($1.8 million).

Amortization of acquired intangible assets. Amortization of acquired intangible assets was $0.4 million for both the three months ended September 30, 2011 and 2010. This expense represents amortization in the period for intangible assets associated with product related assets obtained in the Scient x acquisition.

Gross profit. Gross profit was $30.2 million for the three months ended September 30, 2011 compared to $28.9 million for the three months ended September 30, 2010, representing an increase of $1.3 million, or 4.4%. The increase was due to increased sales of Alphatec products in the International regions ($2.4 million), offset by a decrease in gross margin for Alphatec products in the U.S. ($0.7 million) and a decrease in the sales of Scient x products ($0.4 million).

Gross margin. Gross margin was 63.4% for the three months ended September 30, 2011 compared to 64.5% for the three months ended September 30, 2010. The decrease of 1.1 percentage points was the result of a decrease in the gross margin of Alphatec products from 72.0% to 67.0%, offset by an increase in the gross margin of Scient x products from 36.6% to 43.1%.

Gross margin for the U.S. region was 68.1% for the three months ended September 30, 2011 compared to 77.8% for the three months ended September 30, 2010. The decrease of 9.7 percentage points was the result of reduced gross margin for Alphatec products primarily related to increased cost of revenues due to unfavorable manufacturing and absorption variances.

Gross margin for the International region was 53.3% for the three months ended September 30, 2011 compared to 37.6% for the three months ended September 30, 2010. The increase of 15.6 percentage points was the result of increased gross margin for Alphatec products (12.3 percentage points) and Scient x products (9.9 percentage points) primarily related to a variation in product mix and pricing.

Research and development expense. Research and development expense was $3.9 million for the three months ended September 30, 2011 compared to $3.8 million for the three months ended September 30, 2010, representing an increase of $0.1 million, or 2.9%.

In-process research and development expense. IPR&D expense was $0 for the three months ended September 30, 2011 compared to $2.4 million for the three months ended September 30, 2010. During the three months ended September 30, 2010, we incurred expenses of $2.0 million for the acquisition of technology related to stem cells and $0.4 million for the acquisition of bone-anchoring screw technology. We did not make any acquisitions during the three months ended September 30, 2011.

Sales and marketing expense. Sales and marketing expense was $19.1 million for the three months ended September 30, 2011 compared to $17.1 million for the three months ended September 30, 2010, representing an increase of $2.0 million, or 12.3%. The increase was primarily related to investments to drive sales growth in the International regions.

General and administrative expense. General and administrative expense was $8.6 million for the three months ended September 30, 2011 compared to $7.9 million for the three months ended September 30, 2010, representing an increase of $0.7 million, or 8.7%. The increase resulted from an expanded administrative structure to drive global sales growth.

Amortization of acquired intangible assets. Amortization of acquired intangible assets was $0.5 million for the three months ended September 30, 2011 compared to $0.5 million for the three months ended September, 30 2010. This expense represents amortization in the period for intangible assets associated with general business assets obtained in the Scient x acquisition.

Restructuring expense. Restructuring expense was $0.4 million for the three months ended September, 30 2011 compared to $0.7 million for the three months ended September 30, 2010. The restructuring expenses were due to severance and other personnel costs incurred in connection with restructuring activities in the United States.

Interest income. Interest income was de minimus for the three months ended September 30, 2011 compared to $0.3 million for the three months ended September 30, 2010. The decrease between periods was primarily due to lower average cash and cash equivalent balances.

Interest expense. Interest expense was $0.7 million for the three months ended September 30, 2011 compared to $1.4 million for the three months ended September 30, 2010, representing a decrease of $0.7 million, or 48.8%. Interest expense consisted primarily of interest on our loan agreements and lines of credit with Silicon Valley Bank and the associated amortization expenses related to loan costs. The reduction in interest expense was due to lower interest rates resulting from a different loan structure during the three months ended September 30, 2011 as compared to 2010.

Other income (expense), net. Other income was $0.2 million for the three months ended September 30, 2011 compared to $0.1 million for the three months ended September 30, 2010, representing an increase in income of $0.1 million, or 188.6%. The increase was primarily due to foreign currency exchange gains.

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Income tax benefit. Income tax was a benefit of $1.5 million for the three months ended September 30, 2011 compared to a benefit of $0.8 million for the three months ended September 30, 2010, representing an increase of $0.7 million, or 99.1%. The income tax benefit 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.

Nine Months Ended September 30, 2011 Compared to the Nine Months Ended September 30, 2010

Revenues. Revenues were $148.2 million for the nine months ended September 30, 2011 compared to $125.6 million for the nine months ended September 30, 2010, representing growth of $22.6 million, or 18.0%. The increase was comprised of $13.0 million and $9.3 million of sales in the U.S. and International regions, respectively.

U.S. revenues were $101.1 million for the nine months ended September 30, 2011 compared to $87.8 million for the nine months ended September 30, 2010, representing an increase of $13.3 million, or 15.2%. The growth was due to increased sales of Alphatec products of $11.6 million from instruments and implants ($8.8 million) and Biologics ($2.8 million). Sales of Scient x products represent an increase of $1.7 million.

International revenues were $47.1 million for the nine months ended September 30, 2011 compared to $37.8 million for the nine months ended September 30, 2010, representing an increase of $9.3 million, or 24.6%. The growth was due to increased sales of Alphatec products of $6.9 million, offset by $1.8 million for the recognition of deferred revenue in 2010 related to a European sale that was not repeated in 2011. Sales of Scient x products represent an increase of $4.2 million. The increase in revenues is inclusive of $4.3 million in favorable exchange rate effect.

Cost of revenues. Cost of revenues was $55.0 million for the nine months ended September 30, 2011 compared to $43.5 million for the nine months ended September 30, 2010, representing an increase of $11.4 million, or 26.3%. The increase was primarily related to greater product costs due to growth in sales and variation in product mix ($2.7 million), an increase due to inventory write-offs resulting from the redesign of a deployment mechanism and the associated instrumentation ($2.1 million), an increase in instrument depreciation costs based on a larger installed base of surgical instruments ($1.0 million), unfavorable manufacturing and absorption variances related to production volume and operational costs ($4.0 million), offset by royalty and sales milestone accruals due to sales mix and timing of contractual obligations ($2.0 million), a decrease in amortization expense related to acquired technology ($0.2 million), and a reduction in inventory obsolescence expense ($0.5 million). Our costs for Scient x products for the nine months ended Setpember 30, 2011 was $4.3 million higher than such product costs for the nine months ended September 30, 2010 as we sold Scient x products for the full nine months of 2011 as compared to only six months in 2010.

Amortization of acquired intangible assets. Amortization of acquired intangible assets was $1.2 million for the nine months ended September 30, 2011 compared to $0.7 million for the nine months ended September 30, 2010, representing an increase of $0.5 million, or 64.8%. This expense represents amortization in the period for intangible assets associated with product related assets obtained in the Scient x acquisition.

Gross profit. Gross profit was $92.0 million for the nine months ended September 30, 2011 compared to $81.3 million for the nine months ended September 30, 2010, representing an increase of $10.7 million, or 13.1%. The increase is comprised of the addition of Scient x products ($2.1 million) and increased sales of Alphatec products in the U.S. ($4.0 million) and International ($4.5 million).

Gross margin. Gross margin was 62.1% for the nine months ended September 30, 2011 compared to 64.8% for the nine months ended September 30, 2010. The decrease of 2.7 percentage points was the result of a decrease in the gross margin of Scient x products from 46.9% to 44.3% and a decrease in Alphatec products from 68.0% to 65.7%.

Gross margin for the U.S. region was 67.6% for the nine months ended September 30, 2011 compared to 73.1% for the nine months ended September 30, 2010. The decrease of 5.5 percentage points was the result of a decrease in Scient x gross margin (21.7 percentage points) and a decrease in Alphatec gross margins (4.6 percentage points), primarily related to inventory write-offs and unfavorable manufacturing and absorption variances.

Gross margin for the International region was 50.2% for the nine months ended September 30, 2011 compared to 45.4% for the nine months ended September 30, 2010. The increase of 4.8 percentage points was the result of increased gross margin for Alphatec products (7.4 percentage points) and Scient x products (1.4 percentage points) primarily related to a variation in product mix and pricing.

Research and development expense. Research and development expense was $13.7 million for the nine months ended September 30, 2011 compared to $12.3 million for the nine months ended September 30, 2010, representing an increase of $1.4 million, or 10.6%. The increase was primarily related to increased European research and development activities to support the Scient x products ($0.9 million), increased testing, consulting and prototypes for new products ($1.0 million), and increased stock compensation expense ($0.2 million), offset by reduced activity

due to the variation in the timing of the development cycle for clinical research and trials ($0.2 million) and biologics products ($0.5 million).

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In-process research and development expense. IPR&D expense was $0 for the nine months ended September 30, 2011 compared to $3.0 million for the nine months ended September 30, 2010. During the nine months ended September 30, 2010, we incurred expenses of $2.5 million for the acquisition of technology related to stem cells, $0.4 million for the acquisition of bone-anchoring screw technology and $0.1 million for the acquisition of technology related to an anterior cervical plate system. We did not make any acquisitions during the nine months ended September 30, 2011.

Sales and marketing expense. Sales and marketing expense was $57.1 million for the nine months ended September 30, 2011 compared to $47.6 million for the nine months ended September 30, 2010, representing an increase of $9.5 million, or 20.0%. The increase was primarily related to expenses related to increased European selling and marketing activities in support of the Scient x products ($4.3 million), increased expense for our international sales force ($2.7 million), and increased selling and marketing activities in the U.S. to increase sales volume ($2.5 million).

General and administrative expense. General and administrative expense was $26.7 million for the nine months ended September 30, 2011 compared to $21.5 million for the nine months ended September 30, 2010, representing an increase of $5.2 million, or 24.2%. The increase was primarily a result of an expanded administrative structure to drive sales growth in both the U.S. and International regions. Specifically, increased expenses resulted from European general and administrative activities in support of the Scient x products ($1.8 million), human resources ($1.3 million), finance and accounting ($0.4 million), information technology ($0.4 million), legal ($1.1 million), and an increase in other administrative costs ($0.2 million).

Amortization of acquired intangible assets. Amortization of acquired intangible assets was $1.6 million for the nine months ended September 30, 2011 compared to $1.0 million for the nine months ended September 30, 2010, representing an increase of $0.6 million, or 62.5%. This expense represents amortization in the period for intangible assets associated with general business assets obtained in the Scient x acquisition.

Transaction-related expense. Transaction-related expense was $0 for the nine months ended September 30, 2011 compared to $3.7 million for the nine months ended September 30, 2010. The transaction-related expenses were for legal, accounting and financial advisory fees associated with the acquisition of Scient x.

Restructuring expense. Restructuring expense was $1.0 million for the nine months ended September 30, 2011 compared to $2.4 million for the nine months ended September 30, 2010, representing a decrease of $1.4 million, or 58.4%. The restructuring expenses were due to severance and other personnel costs incurred in connection with restructuring activities in the United States and Europe.

Interest income. Interest income was $0.1 million for the nine months ended September 30, 2011 compared to $0.3 million for the nine months ended September 30, 2010. The decrease between periods was primarily due to lower average cash and cash equivalent balances.

Interest expense. Interest expense was $2.3 million for the nine months ended September 30, 2011 compared to $3.7 million for the nine months ended September 30, 2010, representing a decrease of $1.4 million, or 38.4%. Interest expense consisted primarily of interest on our loan agreements and lines of credit with Silicon Valley Bank and the associated amortization expenses related to loan costs. The reduction in interest expense was due to lower interest rates resulting from a different loan structure during the first nine months of 2011 as compared to 2010.

Other income (expense), net. Other income was $1.0 million for the nine months ended September 30, 2011 compared to $1.1 million for the nine months ended September 30, 2010, representing a decrease in income of $0.1 million, or 9.8%. The decrease was due to lower foreign currency exchange gains realized in the nine months ended September 30 2011 as compared to the nine months ended September 30, 2010.

Income tax benefit. Income tax was a benefit of $3.0 million for the nine months ended September 30, 2011 compared to a benefit of $0.9 million for the nine months ended September 30, 2010, representing an increase of $2.1 million, or 238.6%. The income tax benefit 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.

Discontinued Operations. The company entered into an agreement to sell one of its wholly owned subsidiaries, IMC Co., to a third party in April 2010 and recorded $0.1 million in income from discontinued operations, net of tax, during the nine months ended September 30, 2010.

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

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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 and restructuring expenses. We believe that the most directly comparable GAAP financial measure to adjusted EBITDA is net income (loss). Adjusted EBITDA has limitations, therefore, it 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 three and nine months ended September 30, 2011 and 2010 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net loss	$ (1,304)	$ (3,790)	$ (6,215)	$ (11,479)
Stock-based compensation	480	573	1,928	2,326
Depreciation	3,671	3,586	11,105	9,462
Amortization of intangible assets	330	122	982	1,245
Amortization of acquired intangible assets	956	906	2,852	1,744
In-process research and development		2,425		2,967
Interest expense, net	677	1,155	2,189	3,425
Income tax benefit	(1,533)	(770)	(3,044)	(899)
Other income, net	(202)	(70)	(958)	(1,062)
Income from discontinued operations				(78)
Acquisition-related inventory step-up		419	751	832
Transaction related expenses		6		3,651
Restructuring expenses	394	702	993	2,389
Adjusted EBITDA	$ 3,469	$ 5,264	$ 10,583	$ 14,523

Non-GAAP earnings (loss) represents net income (loss) excluding the effects of in-process research and development expenses and acquisition related transaction and restructuring expenses. Management does not consider these expenses when it makes certain evaluations of our operations. We believe that the most directly comparable GAAP financial measure to non-GAAP earnings (loss) is net income (loss).

The following is a reconciliation of non-GAAP net income (loss) to the most comparable GAAP measure, net loss, for the three and nine months ended September 30, 2011 and 2010 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net loss	$ (1,304)	$ (3,790)	$ (6,215)	$ (11,479)
In-process research and development		2,425		2,967
Acquisition-related inventory step-up		419	751	832
Amortization of acquired intangible assets	956	906	2,852	1,744
Transaction related expenses		6		3,651
Restructuring expenses	394	702	993	2,389
Non-GAAP net income (loss)	$ 46	$ 668	$ (1,619)	$ 104

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The following is a reconciliation of non-GAAP net income (loss) per share to the most comparable GAAP measure, net loss per common share, for the three and nine months ended September 30, 2011 and 2010 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net loss per share, basic and diluted	$ (0.01)	$ (0.04)	$ (0.07)	$ (0.15)
In-process research and development		0.03		0.04
Acquisition-related inventory step-up		0.00	0.01	0.01
Amortization of acquired intangible assets	0.01	0.01	0.03	0.02
Transaction related expenses		0.00		0.05
Restructuring expenses	0.00	0.01	0.01	0.03
Non-GAAP net income (loss) per common share-basic and diluted	$ 0.00	$ 0.01	$ (0.02)	$ 0.00

Pro Forma Information

The following unaudited pro forma information presents the condensed consolidated results of operations of us and Scient x as if the acquisition had occurred on January 1, 2010 (in thousands, except gross margin and share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Pro Forma Combined:				
Revenues	$ 47,619	$ 44,846	$ 148,201	$ 136,927
Loss from operations	$ (1,968)	$ (2,767)	$ (7,035)	$ (5,209)
Net loss	$ (910)	$ (3,082)	$ (5,222)	$ (5,922)
Net loss per share, basic and diluted	$ (0.01)	$ (0.04)	$ (0.06)	$ (0.07)
Gross margin	63.4%	64.5%	62.1%	63.6%
Pro Forma Adjusted EBITDA	$ 3,469	$ 5,264	$ 10,583	$ 15,116

The following is a reconciliation of pro forma adjusted EBITDA to pro forma net loss for the three and nine months ended September 30, 2011 and 2010 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Pro Forma net loss	$ (910)	$ (3,082)	$ (5,222)	$ (5,922)
Stock-based compensation	480	573	1,928	2,429
Depreciation	3,671	3,586	11,105	9,832
Amortization of intangible assets	1,286	1,028	3,834	3,830
In-process research and development		2,425		2,967
Interest expense, net	677	1,155	2,189	3,605
Income tax benefit	(1,533)	(770)	(3,044)	(971)
Other income, net	(202)	(70)	(958)	(1,870)
Income from discontinued operations				(78)
Acquisition-related inventory step-up		419	751	1,268
Non-controlling interest				26
Pro Forma Adjusted EBITDA	$ 3,469	$ 5,264	$ 10,583	$ 15,116

The pro forma information is not necessarily indicative of what the results of operations actually would have been had the acquisition been completed on the date indicated. In addition, it does not purport to project the future operating results of the combined entity. The pro forma

condensed combined financial information is presented for illustrative purposes only and does not reflect the realization of potential cost savings, revenue synergies or any restructuring costs.

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Liquidity and Capital Resources

At September 30, 2011, our principal sources of liquidity consisted of cash and cash equivalents of $22.1 million and accounts receivable, net of $39.8 million. On March 26, 2010, we completed our acquisition of Scient x. Subsequent to the closing of the acquisition, we became responsible for managing the operations of the combined entities. Based on our plan for combining the operating activities of these two companies, which includes a combined 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 September 30, 2012, including the integration of Scient x, as discussed below.

Our Amended Credit Facility with Silicon Valley Bank, or SVB, contains financial covenants consisting of a minimum adjusted quick ratio and minimum quarterly free cash flow. As of September 30, 2011, we were not in compliance with the minimum adjusted quick ratio covenant or the minimum quarterly free cash flow covenant. In November 2011, we executed an agreement for a third amendment to the Amended Credit Facility, or, the Third Amended Credit Facility with SVB. The Third Amended Credit Facility included a waiver for non-compliance with the minimum quarterly financial covenants for the quarterly period ended September 30, 2011 and it also restructured the credit facility terms including future financial covenants (See Credit Facility and Other Debt below).

Based on our current operating plan, we believe that it is reasonably likely that we will be in compliance with our financial covenants of the Third Amended Credit Facility in 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 growth or incur costs in excess of our forecasts, we may be required to substantially reduce discretionary spending, and we could be in default of the Third Amended Credit Facility. In addition to the financial covenants, the Third Amended Credit Facility contains other covenants including subjective covenants that would allow the lender to declare the loan immediately due and payable. Upon the occurrence of a covenant violation or other event of default that is not waived, the lender could elect to declare all amounts outstanding under the Third Amended Credit Facility to be immediately due and payable and terminate all commitments to extend further credit. If the lender were to accelerate the repayment of borrowings under the Third Amended Credit Facility for any reason, we may not have sufficient cash on hand to repay the amounts borrowed under the Third Amended Credit Facility and would be forced to obtain alternative financing.

If we are not able to achieve the minimum targeted revenue growth and related improvements in profitability to meet the quarterly covenants or we have other unanticipated expenditures, we may be required to attempt to seek a waiver of such covenants, renegotiate the amended credit facility, seek additional capital and/or substantially reduce discretionary spending, which could have a material adverse effect on our ability to achieve our intended business objectives. There can be no assurances that such a waiver could be obtained, that the Third Amended Credit Facility could be successfully renegotiated or that we could modify our operations to maintain liquidity. If we are unable to obtain any required waivers or amendments, the lender would have the right to exercise remedies specified in the Third Amended Credit Facility, including accelerating the repayment of debt obligations as discussed above. We 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.

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 property and equipment and repayments of borrowings. 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 will need to invest in working capital and surgical instruments (the costs of which are capitalized) in order to support our revenue projections through 2011. 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.

A substantial portion of our available cash funds is in business accounts with reputable financial institutions. However, our deposits, at times, may exceed federally insured limits. 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 September 30, 2011.

As a result of recent volatility in the capital markets, the cost and availability of credit has been and may continue to be adversely affected by illiquid credit markets and wider credit spreads. Concern about the stability of the markets generally and the strength of counterparties specifically has led many lenders and institutional investors to reduce, and in some cases, cease to provide funding to borrowers. Continued turbulence in the U.S. and international markets and economies may adversely affect our ability to obtain additional financing on terms

acceptable to us, or at all. If these market conditions continue, they may limit our ability to timely replace maturing liabilities and to access the capital markets to meet liquidity needs.

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Operating Activities

We generated net cash of $11.1 million from operating activities for the nine months ended September 30, 2011. During this period, net cash provided by operating activities primarily consisted of a net loss of $6.2 million and an decrease in working capital and other assets of $1.4 million, which were offset by $18.7 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 decrease in working capital and other assets of $1.4 million consisted of increases in accounts receivable of $1.9 million, increases in inventory of $0.2 million and decreases in accrued expenses and other liabilities of $1.6 million, partially offset by increases in accounts payable of $1.0 million and decreases in prepaid expenses and other assets of $1.3 million.

Investing Activities

We used net cash of $9.1 million in investing activities for the nine months ended September 30, 2011 primarily for the purchase of $8.1 million in surgical instruments, computer equipment, leasehold improvements and manufacturing equipment, payment for the acquisition of our Brazilian subsidiary of $0.6 million and the purchase of intangible assets of $0.4 million.

Financing Activities

We used net cash of $3.0 million from financing activities for the nine months ended September 30, 2011. Cash received from the exercise of stock options totaled $0.1 million and borrowings under our line of credit totaled $1.7 million. We made payments on our line of credit of $3.1 million and other principal payments on notes payable and capital lease obligations totaling $1.7 million.

Credit Facility and Other Debt

In October 2010, we amended and restated our Credit Facility with SVB, or, the Amended Credit Facility. The Amended Credit Facility consists of a working capital line of credit, which permits us to borrow up to $32 million. The actual amount available is based on eligible accounts receivable and eligible inventory. The working capital line of credit carries an interest rate of the greater of 5.5% or the SVB prime rate plus 1.5%. Interest-only payments are due monthly and the principal is due at maturity, which occurs in October 2013. The working capital line of credit was intended to refinance our existing debt facilities and to support future working capital needs.

Upon execution of the Amended Credit Facility, we drew $17.6 million on the working capital line of credit, resulting in a total line of credit draw of $31.9 million. The funds from the working capital line of credit were used to pay off our then-existing term loans with SVB and Oxford totaling $9.5 million and Scient x s then-existing term loan of $5.3 million with Oxford. In addition, we paid early termination and other fees of $0.5 million, a final finance charge of $1.2 million and accrued monthly interest of $0.2 million. We incurred debt issuance costs on the Amended Loan Agreement of $0.6 million, which included an upfront fee of $0.2 million paid to SVB. The debt issuance costs were capitalized and are being amortized over the term of the loan using the effective interest method. In addition, we recorded non-cash interest expense of approximately $0.5 million to write off our debt issuance costs and debt discount related to our prior term loans.

To secure the repayment of any amounts borrowed under the Amended Credit Facility, we granted to SVB a first-priority security interest in all of our assets, other than its owned and licensed intellectual property assets. We also agreed not to pledge or otherwise encumber our intellectual property assets without the consent of SVB.

The Amended Credit Facility contains customary lending and reporting covenants, which, among other things, prohibit us from assuming further debt obligations and any liens, unless otherwise permitted under the Amended Credit Facility. Upon the occurrence of an event of default, which includes the failure to make payments when due, breaches of representations, warranties or covenants, the occurrence of certain insolvency events, or the occurrence of an event or change that could have a material adverse effect on us, the interest to be charged pursuant to the Amended Credit Facility will be increased to a rate that is up to five percentage points above the rate effective immediately before the event of default, and all outstanding obligations become immediately due and payable.

We are also required to maintain compliance with financial covenants consisting of a minimum adjusted quick ratio and minimum quarterly free cash flow. The minimum adjust quick ratio is defined as the sum of our cash held with SVB and 80% of eligible domestic accounts receivable divided by the Amended Credit Facility balance. Free cash flow is defined as Adjusted EBITDA (a non-GAAP term defined as 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 and restructuring expenses), less capital expenditures and cash taxes.

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In January 2011, we executed a first amendment to the Amended Credit Facility with SVB. The working capital line of credit interest rate was amended to equal the SVB prime rate plus 3.5% during the first half of 2011, the SVB prime rate plus 3.0% during the third quarter of 2011, the SVB prime rate plus 2.0% during the fourth quarter of 2011, and the greater of 5.5% or the SVB prime rate plus 1.5% thereafter. In addition, the adjusted quick ratio covenant was amended to allow for a lower minimum ratio. There was no change to the minimum quarterly free cash flow covenant requirements.

In August 2011, we executed a second amendment to the Amended Credit Facility with SVB. The working capital line of credit interest rate was amended to equal the greater of 5.5% or the SVB prime rate plus 2.0% beginning on January 1, 2012. There was no change to the financial covenant requirements.

As of September 30, 2011, we were not in compliance with the minimum adjusted quick ratio covenant or the minimum quarterly free cash flow covenant. In November 2011, we executed an agreement for a third amendment to the Amended Credit Facility, or, the Third Amended Credit Facility, with SVB. The Third Amended Credit Facility included a waiver for non-compliance with the minimum quarterly financial covenants for the quarterly period ended September 30, 2011 and it also restructured the credit facility terms including future financial covenants.

The Third Amended Credit Facility consists of a $10 million term loan and a working capital line of credit which permits us to borrow up to $22 million. The actual amount available under the line of credit is based on eligible accounts receivable and eligible inventory. The term loan carries a fixed interest rate equal to the SVB prime rate plus 4.5% with principal plus interest repayments due in 16 equal quarterly installments. A finance charge of $100,000 is waived in exchange for the issuance of warrants to SVB to purchase shares of our common stock. The term loan matures October 2015 and we will pay a prepayment penalty if the term loan is repaid prior to maturity. The funds from the term loan were intended to refinance a portion of the line of credit under the amended credit facility. The working capital line of credit carries an interest rate equal to the SVB prime rate plus 3.5%, with calculated minimum monthly interest of $116,000. Interest only payments are due monthly and the principal is due at maturity, October 2013, which is consistent with the amended credit facility. A finance charge of $50,000 is waived in exchange for the issuance of warrants to SVB to purchase shares of our common stock.

Under the Third Amended Credit Facility, we are required to maintain compliance with financial covenants consisting of a quarterly minimum adjusted quick ratio and a quarterly minimum EBITDA level as well as a maximum annual capital expenditures limit. The minimum adjust quick ratio is defined as the sum of our cash held with SVB and 80% of eligible domestic accounts receivable divided by the total balance of debt owed to SVB. EBITDA, a non-GAAP term, is defined as 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 and restructuring expenses.

The remaining terms under the Third Amended Credit Facility were not amended from the Amended Credit Facility.

The balance of the line of credit as of September 30, 2011 was $30.4 million. However, based on the future commitments under the Third Amended Credit Facility we have reclassified $1.9 million of term loan principal payments from long-term debt to current portion of long-term debt as of September 30, 2011.

For the three and nine months ended September 30, 2011, interest expense on the working capital line of credit, excluding amortization of debt issuance costs totaled $0.6 million and $1.7 million, respectively. For the three and nine months ended September 30, 2010, interest expense for the term loans and our working capital line of credit, excluding debt discount and debt issuance cost amortization and accretion of the additional finance charge, totaled $0.8 million and $2.4 million, respectively.

Alphatec Pacific has a term note payable of $0.6 million with Resona Bank, which is payable over 30 months with a 3.75% interest rate. Alphatec Pacific has additional notes payable to Japanese banks and a bond payable, bearing interest at rates ranging from 1.5% to 6.5% and maturity dates through January 2014 which are collateralized by substantially all of the assets of Alphatec Pacific and Japan Ortho Medical. As of September 30, 2011 the balance of the notes and the bond totaled $0.2 million.

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We have various capital lease arrangements. The leases bear interest at rates ranging from 4.5% to 7.4%, are generally due in monthly principal and interest installments, are collateralized by the related equipment, and have various maturity dates through January 2014. As of September 30, 2011, the balance of these capital leases totaled $0.3 million.

In March 2011, we executed a note payable to a third party for the purchase of software licenses, bearing interest at a rate of 4.6% and a maturity date of March 2012. The balance of this note as of September 30, 2011 was $0.1 million.

We have financing agreements totaling $1.6 million for the payment of premiums on various insurance policies. The financing arrangements bear interest at a rate of 4.7% to 5.3% and are payable from March 2011 through October 2011. Such financing agreements had been fully repaid as of September 30, 2011.

In February 2010, we executed a note payable to Oracle for the purchase of software and the related support totaling $0.9 million. The note bears interest at 5.3% and has maturity date of February 2013. Payments of principal and interest are due every three months. The balance of this note as of September 30, 2011 was $0.3 million.

Contractual obligations and commercial commitments

Total contractual obligations and commercial commitments as of September 30, 2011 are summarized in the following table (in thousands):

		Payment Due by Year					
	Total	2011 (3 months)	2012	2013	2014	2015	Thereafter
Term loan with SVB	$ 10,000	$	$ 2,500	$ 2,500	$ 2,500	$ 2,500	$
Line of Credit with SVB	20,398			20,398			
Note payable for software licenses	121	57	64				
Note payable to Oracle	292	86	206				
Notes and bond payable to Japanese banks	224	19	141	59	5		
Capital lease obligations	277	44	174	58	1		
Operating lease obligations	14,228	982	3,717	3,191	2,811	2,251	1,276
Guaranteed minimum royalty obligations	11,869	469	1,600	3,100	3,350	3,350	
New product development milestones (1)	10,100	100	6,000	4,000			
Total	$ 67,509	$ 1,757	$ 14,402	$ 33,306	$ 8,667	$ 8,101	$ 1,276

(1) This commitment represents payments in cash, and is subject to attaining certain development milestones such as FDA approval, product design and functionality testing requirements, which we believe are reasonably likely to be achieved in 2011 through 2013.

Stock-based Compensation

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Cost of revenues	$ 47	$ 72	$ 139	$ 195
Research and development	(70)	(307)	225	24
Sales and marketing	183	364	569	854
General and administrative	320	444	995	1,253
Total	$ 480	$ 573	$ 1,928	$ 2,326

Effect on basic and diluted net loss per share	$ (0.01)	$ (0.01)	$ (0.02)	$ (0.03)

Recent Accounting Pronouncements

In September 2011, the Financial Accounting Standards Board, or FASB, amended its goodwill guidance by providing entities an option to use a qualitative approach to test goodwill for impairment. An entity will be able to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If it is concluded that this is the case, it is necessary to perform the currently prescribed two-step goodwill impairment test. Otherwise, the two-step goodwill impairment test is not required. The amendment will be effective for the Company on January 1, 2012. We do not anticipate that this amendment will have a material impact on our financial position or results of operations.

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In September 2011, the FASB issued new accounting guidance that requires total comprehensive income, the components of net income and the components of other comprehensive income to be presented either in a single continuous statement or in two separate but consecutive statements. This guidance will be effective for us in the fiscal year beginning January 1, 2012. The new guidance eliminates the current option to report other comprehensive income and its components in the statement of shareholders equity. While the new guidance changes the presentation of other comprehensive income, there are no changes to the components that are recognized in other comprehensive income. Other than presentation, the adoption of this guidance will not have an impact on our financial position or results of operations.

Forward Looking Statements

This Quarterly Report on Form 10-Q incorporates 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 following our acquisition of Scient x;
- our ability to market, commercialize and achieve market acceptance of any of our products or any product candidates that we are developing or may develop in the future;
- our ability to successfully integrate, and realize benefits from our acquisition of, Scient x;
- our ability to successfully achieve and maintain regulatory clearance or approval for our products in applicable jurisdictions;
- 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 without limitation 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;
- trends related to the treatment of spine disorders, including without limitation the aging spine market;
- our ability to control our costs, achieve profitability, and the potential need to raise additional funding;
- the amount of our legal expenses associated with the securities and stockholder derivative litigation, litigation regarding our intellectual property and any future litigation that may arise, and the adequacy of our insurance policy coverage regarding those expenses and any damages or settlement payments related to such litigation;
- 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;

the difficulty in accurately predicting the future purchases of our U.S.-based and international stocking distributors;

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 obtain alternative financing, if needed;

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

our ability to establish the industry standard in clinical and legal compliance and corporate governance programs;

the effects of the loss of key personnel;

potential liability resulting from litigation;

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potential liability resulting from a governmental review of our or Scient x s business practices; and

other factors discussed elsewhere in this Form 10-Q or any document incorporated by reference herein or therein.

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

We also provide a cautionary discussion of risks and uncertainties under Risk Factors in Item 1A of this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K for the year ended December 31, 2010 as well as any updates to those risk factors filed from time to time in our Quarterly Reports on Form 10-Q or Current Reports on Form 8-K. 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 believes, anticipates, plans, expects and similar expressions are intended to identify forward-looking statements. There are a number of factors 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 3. 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 September 30, 2011, our outstanding floating rate indebtedness totaled $30.4 million. The primary base interest rate is the U.S. federal prime rate. 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 $0.3 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. 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% change in commodity prices would not have a material impact on our results of operations for the three months ended September 30, 2011.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports pursuant to the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange

Commission 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.

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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 Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on the foregoing, 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, to ensure 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.

Changes in Internal Control over Financial Reporting

There has been no change in our internal controls over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

(a) *Evaluation of Disclosure Controls and Procedures*. Our principal executive officer and principal financial and accounting officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this Quarterly Report on Form 10-Q, have concluded that, based on such evaluation, our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in the 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, and is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, our 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 our management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

(b) *Changes in Internal Controls*. There were no changes in our internal control over financial reporting, identified in connection with the evaluation of such internal control that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Litigation

In January 2011, we filed a complaint in the U.S. District Court for the Southern District of California against Biomet, Inc., alleging that Biomet s TPS-TL products infringe one of our patents. We are seeking money damages, attorneys fees and interest. The outcome of the litigation cannot be predicted at this time and there can be no assurance that we will be successful in our claims.

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, *Cross Medical Products, LLC v. Alphatec Spine, Inc.,* Case No. 8:10-cv-00176-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 is seeking payment of prior royalties allegedly due from our sales of polyaxial screws and an order from the court regarding payment of future royalties by us. In its complaint, Cross alleges a material amount of damages are due to it as a result of our alleged breach of the patent license agreement. We denied the allegations in our answer to the complaint and intend to vigorously defend ourselves against the complaint. In February 2011 and July 2011, the court issued orders granting Cross s motions for partial summary judgment, and limiting our counterclaims. The court rulings interpreted the license agreement as asserted by Cross, and found that the license agreement, as so interpreted, is enforceable. We intend to appeal the trial court s decisions. A trial to determine which products are subject to the patent license agreement, and therefore under the interpretation of the trial court subject to royalty payment, is currently scheduled for February 2012. We believe the damages are not currently estimable, as discovery with respect to this phase of the trial is still ongoing, but a judgment for damages in favor of Cross would have a material adverse effect on our results of operations, financial condition and cash flows.

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, or Orthotec. In 2004, Orthotec sued Eurosurgical in connection with a contractual dispute and a $9 million judgment was entered against Eurosurgical by a California court. At the same time, 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 approved by a French court. Pursuant to this sale, Surgiview became a subsidiary of Scient x in 2006. Orthotec attempted to recover on Eurosurgical s obligations in California and federal courts 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 May 2008, after the acquisition of Scient x by HealthpointCapital in 2007, Orthotec sued Scient x, Surgiview, HealthpointCapital and certain Scient x directors (who also serve on our board) in a new action in California state court. In addition at the same time, a similar action was filed in New York against HealthpointCapital and two directors of Scient x (who also serve on our board). In April 2009, the California court dismissed this matter on jurisdictional grounds, and Orthotec appealed such ruling. In December 2010, the California Court of Appeal issued a decision that affirmed in part

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and reversed in part the trial court s decision dismissing the entire California action based on lack of personal jurisdiction. The Court of Appeal affirmed the trial court s ruling that Orthotec failed to establish personal jurisdiction over all parties except Surgiview, finding that the trial court could exercise jurisdiction over that entity. In November 2009, the New York court dismissed Orthotec s claims based on collateral estoppel, and Orthotec appealed this ruling. In March 2011, the state appeals court in NY reversed the lower court s decision to dismiss Orthotec s claims, and the New York matter is proceeding with HealthpointCapital and certain Scient x directors (who also serve on our board) as the only defendants. While we intend to vigorously defend against the complaint, and believe that the plaintiff s allegations are without merit, the outcome of the litigation cannot be predicted at this time and any outcome in favor of Orthotec could have a significant adverse effect on our financial condition and results of operations.

In 2004, Scient x SA s wholly owned U.S. subsidiary, Scient x USA, Inc., or Scient x USA, entered into a distribution agreement with DAK Surgical, Inc. and DAK Spine, Inc., two independent distributors, or, collectively DAK, for the distribution of products in certain defined sales areas. In September 2007, shortly after the expiration of the distribution contract, DAK, and their principals filed a lawsuit in Florida state court against Scient x USA and Scient x SA in which they alleged, among other things, that (i) Scient x USA breached the distribution agreement, (ii) Scient x USA interfered with DAK s business relationships, and (iii) personnel at Scient x USA made defamatory remarks regarding the principals of DAK. In February 2011, the court granted Scient x USA s Partial Motion for Summary Judgment finding that there was no obligation for Scient x USA or Scient x SA to pay DAK under a change of ownership clause in the distribution agreement with DAK. While we believe that the plaintiff s remaining allegations are also without merit, and we intend to vigorously defend ourselves against this complaint, the outcome of the litigation cannot be predicted at this time and any outcome in favor of DAK could have a significant adverse effect on our financial condition and results of operations.

In August 2009, a complaint filed under the qui tam provisions of the United States Federal False Claims Act, or the FCA, that had been filed by private parties against Scient x USA was unsealed by the United States District Court for the Middle District of Florida (Hudak v. Scient x USA, Inc., et al. (Civil Action No. 6:08-cv-1556-Orl-22DAB, U.S. District Court, W.D. Florida). The complaint, which was filed under seal in September 2008, alleged violations of the FCA arising from allegations that Scient x USA made improper consulting payments to surgeon customers. The private parties who filed the complaint were the principals of the plaintiff in the DAK Surgical matter discussed above. Under the FCA, the Civil Division of the United States Department of Justice, or DOJ, had a certain period of time in which to decide whether to intervene and conduct the action against Scient x, or to decline to intervene and allow the private plaintiffs to proceed with the case. In August 2009, the DOJ filed a notice informing the court that it was declining to intervene in the case. In December 2009, the private plaintiffs who filed the action moved the court to dismiss the matter without prejudice, the Attorney General consented to such dismissal and the matter was dismissed without prejudice. Despite the dismissal of this matter, the DOJ informed the company that it is continuing its review of the facts alleged by the original plaintiffs in this matter. To date, neither we nor Scient x USA have been subpoenaed by any governmental agency in connection with this review. We believe that Scient x USA s business practices were in compliance with the FCA and intend to vigorously defend the company with respect to the allegations contained in the qui tam complaint, however, the outcome of the matter cannot be predicted at this time and any adverse outcome could have a significant adverse effect on our financial condition and results of operations.

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 its directors and executives alleging violations of the Securities Exchange Act of 1934, as amended, and Rule 10b-5 thereunder. On February 17, 2011, an amended complaint was filed against us and certain of our directors and officers adding alleged violations of the Securities Act of 1933. 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 our 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 the claims are without merit and intend to vigorously defend ourself against this complaint; however no assurances can be given as to the timing or outcome of this lawsuit.

On August 25, 2010, an alleged shareholder of ours filed a derivative lawsuit in the Superior Court of California, San Diego County, purporting to assert claims on behalf of us against all of our directors and certain of our 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. We have been named as a nominal defendant in the consolidated action. Each complaint alleges that our directors and certain of our officers breached their fiduciary duties to our related to the Scient x transaction, and by making allegedly false statements that led to unjust enrichment of HealthpointCapital and certain of our directors. The complaints seek unspecified monetary damages and an order directing us to adopt certain measures purportedly designed to improve its corporate governance and internal procedures. This consolidated lawsuit has been stayed by order of the court until August 26, 2012. We believe the claims are without merit and intend to vigorously defend ourself against these complaints; however no assurances can be given as to the timing or outcome of this lawsuit.

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At September 30, 2011, 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. We are 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 the our future consolidated results of operations, cash flows or financial position in a particular period.

Item 1A. Risk Factors

There have been no material changes to the risk factors described under Item 1A of Part I of our Annual Report on Form 10-K for the fiscal year ended December 31, 2010 as well as any updates to those risk factors filed from time to time in our Quarterly Reports on Form 10-Q.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Unregistered Sales of Equity Securities

None.

Issuer Purchases of Equity Securities

Under the terms of our Amended and Restated 2005 Employee, Director and Consultant Stock Plan, or the 2005 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 2005 Plan and are available for future awards under the terms of the 2005 Plan. Shares repurchased during the three months ended September 30, 2011 were as follows:

Month/Year	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
July 2011		$		
August 2011		$		
September 2011		$		

(1) Not included in the table above are 16,344 forfeited and retired shares 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 6. Exhibits

*10.1	Non-Executive Chairman Consulting Agreement by and among Alphatec Spine, Inc., Alphatec Holdings, Inc. and Leslie Cross dated July 27, 2011.
31.1	Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	The following materials from Alphatec Holdings, Inc. s Quarterly Report on Form 10-Q for the quarter ended September 30, 2011, formatted in XBRL (eXtensible Business Reporting Language); (i) Condensed Consolidated Balance Sheets as of September 30, 2011 and December 31, 2010, (ii) Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2011 and 2010, (iii) Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2011 and 2010, and (iv) Notes to Condensed Consolidated Financial Statements**.

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* Management contract or compensatory plan or arrangement.

** Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

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SIGNATURES

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

ALPHATEC HOLDINGS, INC.

By: /s/ Dirk Kuyper
Dirk Kuyper

President and Chief Executive Officer

(principal executive officer)

By: /s/ Michael O Neill
Michael O Neill

Chief Financial Officer, Vice President and Treasurer

(principal financial and accounting officer)

Date: November 4, 2011

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