

Alphatec Holdings, Inc.
Form 10-Q
August 04, 2009
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2009

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission file number 000-52024

ALPHATEC HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

20-2463898
(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

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(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 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 No

Indicate by check mark whether the registrant is a large accelerated filer, an 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 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

As of August 3, 2009, there were 52,311,204 shares of the registrant's common stock outstanding.

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ALPHATEC HOLDINGS, INC.
QUARTERLY REPORT ON FORM 10-Q

June 30, 2009

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****ALPHATEC HOLDINGS, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(UNAUDITED)****(In thousands, except for par value data)**

	June 30, 2009	December 31, 2008
Assets		
Current assets:		
Cash and cash equivalents	\$ 19,731	\$ 18,315
Accounts receivable, net	23,824	18,759
Inventories, net	27,749	24,170
Prepaid expenses and other current assets	4,038	3,847
Deferred income tax assets	413	418
Total current assets	75,755	65,509
Property and equipment, net	28,862	23,093
Goodwill	60,087	60,124
Intangibles, net	2,705	4,280
Other assets	1,706	2,542
Total assets	\$ 169,115	\$ 155,548
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	\$ 13,809	\$ 10,504
Accrued expenses	22,167	16,739
Deferred revenue	2,865	1,858
Current portion of long-term debt	4,439	2,109
Total current liabilities	43,280	31,210
Long-term debt, less current portion	26,577	26,488
Other long-term liabilities	1,747	1,889
Deferred income tax liabilities	964	887
Redeemable preferred stock, \$0.0001 par value; 20,000 authorized at June 30, 2009 and December 31, 2008; 3,319 and 3,320 shares issued and outstanding at June 30, 2009 and December 31, 2008, respectively	23,605	23,605
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$0.0001 par value; 200,000 authorized at June 30, 2009 and December 31, 2008; 51,760 and 47,411 shares issued and outstanding at June 30, 2009 and December 31, 2008, respectively	5	5
Additional paid-in capital	170,671	158,140
Accumulated other comprehensive income	1,123	1,495
Accumulated deficit	(98,857)	(88,171)
Total stockholders' equity	72,942	71,469

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Total liabilities and stockholders' equity	\$ 169,115	\$ 155,548
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See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents**ALPHATEC HOLDINGS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(UNAUDITED)****(in thousands, except per share amounts)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Revenues	\$ 32,263	\$ 23,853	\$ 62,873	\$ 47,050
Cost of revenues	11,412	8,016	22,242	15,903
Gross profit	20,851	15,837	40,631	31,147
Operating expenses:				
Research and development	3,436	3,354	6,303	6,558
In-process research and development	4,493		5,783	1,300
Sales and marketing	12,810	10,062	25,594	20,165
General and administrative	5,563	5,740	11,526	11,304
Litigation settlement				11,000
Total operating expenses	26,302	19,156	49,206	50,327
Operating loss	(5,451)	(3,319)	(8,575)	(19,180)
Other income (expense):				
Interest income	16	104	50	305
Interest expense	(918)	(269)	(1,834)	(447)
Other income (expense), net	166	(38)	(95)	113
Total other income (expense)	(736)	(203)	(1,879)	(29)
Loss before taxes	(6,187)	(3,522)	(10,454)	(19,209)
Income tax provision	116	69	232	161
Net loss	\$ (6,303)	\$ (3,591)	\$ (10,686)	\$ (19,370)
Net loss per common share:				
Basic and diluted	\$ (0.13)	\$ (0.08)	\$ (0.23)	\$ (0.42)
Weighted-average shares used in computing net loss per share:				
Basic and diluted	47,157	46,274	46,832	46,138

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents**ALPHATEC HOLDINGS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(UNAUDITED)****(in thousands)**

	Six Months Ended June 30,	
	2009	2008
Operating activities:		
Net loss	\$ (10,686)	\$ (19,370)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	5,498	3,673
Stock-based compensation	1,465	1,440
Interest expense related to amortization of debt discount and debt issuance costs	297	
In-process research and development paid in stock	3,013	650
Provision for (recoveries from) doubtful accounts	(25)	106
Provision for excess and obsolete inventory	506	1,295
Gain on sale of property and equipment	(20)	
Deferred income taxes	82	330
Changes in operating assets and liabilities:		
Accounts receivable	(5,268)	(2,139)
Inventories	(4,212)	(2,059)
Prepaid expenses and other current assets	49	(306)
Other assets	425	(826)
Accounts payable	287	804
Accrued expenses and other	3,648	942
Deferred revenues	1,007	1,385
Net cash used in operating activities	(3,934)	(14,075)
Investing activities:		
Proceeds from sale of Noas investment	383	
Purchase of intangible assets		(389)
Purchases of property and equipment (including instruments)	(6,648)	(7,184)
Sale of certificate of deposit		2,000
Net cash used in investing activities	(6,265)	(5,573)
Financing activities:		
Net proceeds from issuance of common stock	9,884	
Borrowings under lines of credit	3,868	8,500
Repayments under lines of credit	(755)	(1,869)
Principal payments on capital lease obligations	(197)	(263)
Proceeds from issuance of notes payable		1,815
Principal payments on notes payable	(893)	(1,151)
Other		22
Net cash provided by financing activities	11,907	7,054
Effect of exchange rate changes on cash and cash equivalents	(292)	(178)
Net increase (decrease) in cash and cash equivalents	1,416	(12,772)
Cash and cash equivalents at beginning of period	18,315	25,843

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Cash and cash equivalents at end of period	\$ 19,731	\$ 13,071
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See accompanying notes to unaudited condensed consolidated financial statements.

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ALPHATEC HOLDINGS, INC.
STATEMENTS OF CASH FLOWS (continued)
(UNAUDITED)
(in thousands)

	Six Months Ended June 30,	
	2009	2008
Supplemental cash flow information:		
Cash paid for interest	\$ 1,182	\$ 363
Cash paid for income taxes	\$ 153	\$ 368
Purchases of property and equipment (including instruments) in accounts payable	\$ 3,135	\$
Financing of insurance premium by insurance provider	\$ 301	\$

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. (Alphatec Spine) is engaged in the development, manufacturing and sale of medical devices for use in spinal surgeries with a focus on providing solutions for products affecting the aging spine. Alphatec Holdings' principal operating activities are conducted through Alphatec Spine and its wholly owned and consolidated subsidiaries, Nexmed, Inc. (Nexmed), a California corporation, Alphatec Pacific, Inc. (Alphatec Pacific), a Japanese corporation, and Milverton Limited, a Hong Kong corporation.

Basis of Presentation

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

The accompanying condensed balance sheet as of December 31, 2008, 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 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 are adequate to make the information not misleading. The interim financial statements reflect all adjustments which, in the opinion of management, are necessary for a fair statement of the results for the periods presented. All such adjustments are of a normal and recurring nature. These unaudited consolidated financial statements should be read in conjunction with the audited financial statements included in Alphatec Holdings' Annual Report on Form 10-K and Amendment No. 1 thereto for the fiscal year ended December 31, 2008 filed with the SEC on March 4, 2009 and July 7, 2009, respectively. Further, in connection with the condensed consolidated financial statements and in accordance with the recently issued Statement of Financial Accounting Standards No. 165, *Subsequent Events*, (SFAS No. 165), the Company evaluated subsequent events after the balance sheet date of June 30, 2009 through August 4, 2009, the date of the filing of these condensed consolidated financial statements.

Operating results for the three months ended June 30, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009, or any other future periods.

The accompanying condensed 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 updated operating plan, management believes that its existing cash and cash equivalents of \$19.7 million and available credit of \$0.4 million at June 30, 2009 will be sufficient to fund its cash requirements through at least June 30, 2010.

In December 2008, the Company entered into a Loan and Security Agreement (the Credit Facility) with Silicon Valley Bank and Oxford Finance Corporation (the Lenders) (See Note 6). In conjunction with the Credit Facility, the Company is required to maintain compliance with individual quarterly measurement of financial covenants, which include a minimum level of revenues and a minimum level of Adjusted EBITDA (a non-GAAP term defined in Note 6). The minimum covenants escalate each quarter during fiscal 2009. In order to meet the financial covenants for 2009, the Company will need to achieve growth over its historical quarterly revenue and earnings levels. The Company's 2009 board of directors approved operating plan shows that the Company would meet the quarterly financial covenants and management believes that it will be able to achieve this operating plan. However, if the Company is not able to achieve its planned revenue growth or incurs costs in excess of its forecast, it could be in default of the Credit Facility. In addition to the financial covenants described above, there are other clauses including subjective clauses that would allow the Lenders to declare the loan immediately due and payable (See Note 6). Upon the occurrence of an event of default under the Credit Facility, the Lenders could elect to declare all amounts outstanding under the Credit Facility to be immediately due and payable and terminate all commitments to extend further credit. If the Lenders were to accelerate the repayment of borrowings under the Credit Facility for any reason, the Company may not have sufficient cash on hand to repay the amounts borrowed under the Credit Facility.

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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 would be required to attempt to renegotiate the Credit Facility and may be required to seek additional capital and/or to substantially reduce discretionary spending, which could have a material adverse effect on the Company's ability to achieve its intended business objectives. The Company may seek additional financing, which may include additional debt and/or equity financing or funding through other third party agreements. There can be no assurance that any additional financing will be available on acceptable terms or available at all. Any equity financing may result in dilution to existing stockholders and any debt financing may include restrictive covenants.

Reclassification

Certain prior year balances have been reclassified in the accompanying condensed consolidated financial statements to conform to the current year presentation. In the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2008 filed with the SEC on August 6, 2008, the Company's operating expenses in Japan were classified as general and administrative expenses. In this Quarterly Report on Form 10-Q, Alphatec separated the Japanese sales and marketing expenses from the general and administrative expenses. This reclassification has no impact upon total operating expenses and net loss, and resulted in the reclassification of \$1.0 million of general and administrative expense to sales and marketing expense for the three months ended June 30, 2008 and of \$2.0 million of general and administrative expense to sales and marketing expense for the six months ended June 30, 2008.

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 fiscal year ended December 31, 2008, included in the Company's Annual Report on Form 10-K filed with the SEC on March 4, 2009, as amended. These accounting policies have not significantly changed during the three months ended June 30, 2009.

Recent Accounting Pronouncements

In May 2009, the Financial Accounting Standards Board (FASB) issued SFAS No. 165 which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS No. 165 is effective for the Company for interim and annual reporting periods ending after June 15, 2009. The adoption of SFAS No. 165 did not have a material impact on the Company's consolidated financial statements.

In April 2009, the FASB issued FSP SFAS No. 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies*. FSP SFAS No. 141(R)-1 addresses application issues on initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. FSP SFAS No. 141(R)-1 is effective for assets or liabilities arising from contingencies in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. FSP SFAS No. 141(R)-1 is effective for the Company beginning January 1, 2009 and will apply to business combinations completed on or after that date.

In December 2007, the FASB issued SFAS No. 141(R) (revised 2007), *Business Combinations*, which replaces SFAS No 141. The statement retains the purchase method of accounting for acquisitions, but requires an acquiring company to measure all assets acquired and liabilities assumed, including contingent considerations and contractual contingencies, at fair value as of the acquisition date. In addition, an acquiring company is required to capitalize in-process research and development and either amortize it over the life of the product, or expense it upon abandonment or impairment. SFAS No. 141(R) also requires expensing of acquisition-related costs as incurred. SFAS No. 141(R) is effective for the Company beginning January 1, 2009 and will apply to business combinations completed on or after that date.

In April 2008, the FASB issued FSP No. 142-3, *Determination of Useful Life of Intangible Assets*. FSP No. 142-3 amends the factors that should be considered in developing the renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets*. FSP No. 142-3 also requires expanded disclosure related to the determination of intangible asset useful lives. FSP 142-3 is effective for the Company beginning January 1, 2009. The adoption of FSP No. 142-3 did not have a material impact on the Company's consolidated financial statements.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles*, which identifies the sources of accounting principles and provides entities with a framework for selecting the principles used in preparation of financial statements that are presented in conformity with GAAP. SFAS No. 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AICPA Codification of Auditing Standards, AU Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*. The adoption of SFAS No. 162 is not expected to have a material impact on the Company's

consolidated financial statements.

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

SFAS No. 157 establishes a framework for fair value using levels which are defined as follows: Level 1 fair value is determined from observable, quoted prices in active markets for identical assets or liabilities. Level 2 fair value is determined from quoted prices for similar items in active markets or quoted prices for identical or similar items in markets that are not active. Level 3 fair value is determined using the entity's own assumptions about the inputs that market participants would use in pricing an asset or liability. As of June 30, 2009, the Company had cash and cash equivalents of \$19.7 million which are considered Level 1 assets. The Company does not have any financial assets or liabilities determined under Levels 2 or 3.

3. Balance Sheet Details**Accounts Receivable**

Accounts receivable consist of the following (in thousands):

	June 30, 2009	December 31, 2008
Accounts receivable	\$ 24,130	\$ 19,092
Allowance for doubtful accounts	(306)	(333)
Accounts receivables, net	\$ 23,824	\$ 18,759

Inventories

Inventories consist of the following (in thousands):

	June 30, 2009			December 31, 2008		
	Gross	Reserve for excess and obsolete	Net	Gross	Reserve for excess and obsolete	Net
Raw materials	\$ 2,155	\$	\$ 2,155	\$ 1,814	\$	\$ 1,814
Work-in-process	1,765		1,765	1,208		1,208
Finished goods	34,842	(11,013)	23,829	32,317	(11,169)	21,148
Inventories, net	\$ 38,762	\$ (11,013)	\$ 27,749	\$ 35,339	\$ (11,169)	\$ 24,170

Property and Equipment

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

	Useful lives (in years)	June 30, 2009	December 31, 2008
Surgical instruments	4	\$ 29,525	\$ 23,505
Machinery and equipment	7	9,715	8,209

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Computer equipment	5	2,578	2,446
Office furniture and equipment	5	3,101	3,011
Leasehold improvements	various	3,146	1,972
Building	39	194	204
Land	n/a	14	15
Construction in progress	n/a	508	787
		48,781	40,149
Less accumulated depreciation and amortization		(19,919)	(17,056)
Property and equipment, net		\$ 28,862	\$ 23,093

Total depreciation expense, including depreciation expense for assets under capital leases, was \$2.1 million and \$1.1 million for the three months ended June 30, 2009 and 2008, respectively, and \$3.9 million and \$2.1 million for the six months ended June 30, 2009 and 2008, respectively.

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The Company has assets under capital leases of \$3.0 million at both June 30, 2009 and December 31, 2008, respectively. Accumulated depreciation on these assets totaled \$2.4 million and \$2.2 million at June 30, 2009 and December 31, 2008, respectively. Depreciation expense for these capital leases was \$0.1 million and \$0.1 million for the three months ended June 30, 2009 and 2008, respectively, and \$0.2 million and \$0.2 million for the six months ended June 30, 2009 and 2008, respectively.

Intangible Assets

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

	Useful lives (in years)	June 30, 2009	December 31, 2008
Developed product technology	5	\$ 13,700	\$ 13,700
Distribution rights	3	3,615	3,787
Supply agreement	10	225	225
		17,540	17,712
Less accumulated amortization		(14,835)	(13,432)
Intangible assets, net		\$ 2,705	\$ 4,280

Total amortization expense was \$0.8 million and \$0.5 million for the three months ended June 30, 2009 and 2008, respectively, and \$1.6 million for both the six months ended June 30, 2009 and 2008.

The future expected amortization expense related to intangible assets as of June 30, 2009 is as follows (in thousands):

Year Ending December 31,	
Remainder of 2009	\$ 1,555
2010	876
2011	100
2012	100
2013	55
Thereafter	19
Total	\$ 2,705

Accrued Expenses

Accrued expenses consist of the following (in thousands):

	June 30, 2009	December 31, 2008
Payroll and related	\$ 3,709	\$ 3,522
Accrued milestone payment	3,550	
Commissions	3,057	2,305
Royalties	2,680	3,011
Reserve for litigation costs	2,200	2,200
Deferred rent	2,657	1,170
Consumption tax	608	76
Legal	500	295

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Current portion of severance payable	49	423
Accrued earnout		316
Other	3,157	3,421
Total accrued expenses	\$ 22,167	\$ 16,739

Deferred Revenues

During the three months ended June 30, 2009, the Company shipped \$1.2 million of product to European distributors, which include extended payment terms. As a result of offering payment terms greater than the Company's customary U.S. business terms, and operating in a new market in which the Company has limited prior experience, revenues for purchases by distributors in Europe have been deferred until the earlier of either the date upon which payments are due or until cash is received for such purchases. The balance in deferred revenue relating to Europe distributors as of June 30, 2009 was \$1.6 million.

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During the three months ended June 30 2009, the Company shipped \$0.2 million of product to a U.S. distributor that did not have an extensive credit history. As a result of a lack of extensive credit history, revenues for purchases by this distributor have been deferred until cash is received. The balance in deferred revenue relating to this distributor as of June 30, 2009 was \$1.3 million.

4. Comprehensive 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 loss for the three and six months ended June 30, 2009 and 2008 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Net loss, as reported	\$ (6,303)	\$ (3,591)	\$ (10,686)	\$ (19,370)
Foreign currency translation adjustment	67	(457)	(372)	312
Comprehensive loss	\$ (6,236)	\$ (4,048)	\$ (11,058)	\$ (19,058)

5. License and Developmental Consulting Agreements*OsseoFix Fracture Reduction System License Agreement*

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

Expandable VBR License and Consulting Agreement

On April 15, 2009, the Company and Stout amended and restated the license agreement that the parties had entered into in March 2008 (the Amended and Restated License Agreement) that provides the Company with a worldwide license to develop and commercialize Stout s proprietary intellectual property related to an expandable interbody/vertebral body replacement device. The effective date of the Amended and Restated License Agreement is March 31, 2009. Under the Amended and Restated License Agreement, the timing of the minimum royalty payments has been adjusted and Stout s ability to terminate the Amended and Restated License Agreement was revised. Under the original license agreement, the Company s minimum royalty obligation began in the year ending December 31, 2010. Pursuant to the Amended and Restated License Agreement, if the Company is required to initiate a clinical trial to obtain clearance from the FDA for a licensed product, the minimum royalty obligation is suspended until such licensed product obtains regulatory approval. In addition, under the terms of the Amended and Restated License Agreement, Stout has the ability to terminate the Amended and Restated License Agreement if the Company has not filed for regulatory approval to market and sell a licensed product within an allotted time period; provided that the Company has the right to delay such termination in exchange for making certain payments to Stout. If, during the time period when such payments are made, the Company were to make a regulatory filing for the marketing and sale of a licensed product, such termination would be null and void. Pursuant to the Amended and Restated License Agreement, Stout is entitled to retain all up-front payments that had been previously paid to it. The other material terms to the original license agreement were not changed in the Amended and Restated License Agreement.

Additionally, effective March 31, 2009 the Company and Stout amended and restated the developmental consulting agreement that the parties had entered into in March 2008 (the Amended and Restated Consulting Agreement) pursuant to which Stout agreed to provide consulting

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services related to the development of an expandable interbody/vertebral body replacement device. Under the Amended and Restated Consulting Agreement, the timing and amount of consulting fees has been adjusted. Under the original consulting agreement, the Company was obligated to make ten monthly payments of \$50,000 to compensate Stout for providing development services. As of the effective date of the Amended and Restated Consulting Agreement, the Company had paid Stout \$0.4 million of such consulting fees, and had expensed \$0.2 million of such expenses. Pursuant to the Amended and Restated Consulting Agreement, Stout is obligated to return such \$0.4 million to the Company, which was received in April 2009. The terms of the Amended and Restated Consulting Agreement call for the Company to pay consulting fees of \$20,000 per month for 12 months beginning in July 2009, provided that the agreement is in full force and effect. Pursuant to the Amended and Restated Consulting

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Agreement, Stout is entitled to retain the 101,944 shares of restricted stock of the Company that the Company had previously issued to Stout. Such restricted stock would become vested upon the attainment of a development milestone. The other material terms to the original consulting agreement were not changed in the Amended and Restated Consulting Agreement. As the total cash consideration has been reduced to \$0.2 million, the Company is recording the remaining amount that had not yet been expensed over the expected development period.

OsseoScrew License Agreement

In December 2007, the Company entered into an exclusive license agreement, or the OsseoScrew License Agreement, with Progressive Spinal Technologies LLC (PST), that provides the Company with an exclusive worldwide license to develop and commercialize PST 's technology related to a pedicle screw designed to be used for patients that have osteopenic bone or poor bone density. The financial terms of the OsseoScrew License Agreement include: (i) a cash payment payable following the execution of the agreement; (ii) development and sales milestone payments in cash and the Company 's common stock that began to be achieved and paid in 2008; and (iii) a royalty payment based on net sales of licensed products with minimum annual royalties beginning in 2009. The Company recorded an IPR&D charge of \$2.0 million in the fourth quarter of 2007 for the initial payment, as the technological feasibility associated with the IPR&D since the final prototype of the device had not been established and no alternative future use exists. The agreement includes milestone payments of \$3.6 million consisting of cash and its common stock upon the completion of the biomechanical testing. Furthermore, the agreement includes milestone payments of \$2.5 million consisting of cash and the Company 's common stock upon market launch, which may occur in the second half of 2009. During the three months ended June 30, 2009, the Company successfully completed one of its development milestones. The Company recorded an IPR&D charge totaling \$3.6 million, which consisted of a cash payment of \$1.8 million and the issuance of \$1.8 million of shares of the Company 's common stock. The amounts were expensed as the technological feasibility associated with the IPR&D had not been established since the final prototype of the device had not been completed, and no alternative future use exists. The total number of shares of common stock, which were issued on July 15, 2009 was 567,821.

Assignment Agreement with Spine Vision, S.A.

In January 2009, the Company entered into an assignment agreement (the Patent and Technology Assignment Agreement) with Spine Vision, S.A (Spine Vision) that assigns the Company all rights, title and interests to certain patents and technology of Spine Vision that relate to a stand-alone locking interbody device. The financial terms of the Patent and Technology Assignment Agreement include: (i) an initial payment of \$0.5 million; and (ii) a royalty payment based on the net sales of any product that contains the assigned intellectual property. During the first quarter of 2009, the Company recorded an IPR&D charge of \$0.5 million for the initial payment, as the technological feasibility associated with the IPR&D had not been established since the final prototype of the device had not been completed, and no alternative future use exists.

License Agreement with Helix Point, LLC

In February 2009, the Company entered into a License Agreement with Helix Point, LLC (the Helifuse/Helifix License Agreement) that provides the Company with a worldwide exclusive license (excluding the People 's Republic of China) to develop and commercialize Helix Point 's proprietary intellectual property related to a device for the treatment of spinal stenosis. The financial terms of the Helifuse/Helifix License Agreement include: (i) a cash payment of \$250,000 payable following the execution of the Helifuse/Helifix License Agreement; (ii) the issuance of \$350,000 of shares of the Company 's common stock following the execution of the Helifuse/Helifix License Agreement; (iii) development and sales milestone payments in cash and the Company 's common stock that could begin to be achieved and paid in 2009; and (iv) a royalty payment based on net sales of licensed products, with minimum annual royalties beginning in the year after the first commercial sale of a licensed product. During the first quarter of 2009, the Company recorded an IPR&D charge of \$0.6 million for the initial cash and stock payment, as the technological feasibility associated with the IPR&D had not been established since the final prototype of the device had not been completed, and no alternative future use exists.

License Agreement with International Spinal Innovations, LLC

In June 2009, the Company entered into a Cross License Agreement with International Spinal Innovations, LLC (the ISI License Agreement) that provides the Company with a worldwide license to develop and commercialize ISI 's proprietary intellectual property related to a stand-alone anterior lumbar interbody fusion device. The financial terms of the ISI License Agreement include: (i) the issuance of 260,000 shares of the Company 's common stock following the execution of the ISI License Agreement; (ii) sales milestone payments in cash that could begin to be achieved and paid in 2011; and (iii) a royalty payment based on net sales of licensed products with minimum annual royalties beginning in the year after the first commercial sale of a licensed product. During the three months ended June 30, 2009, the Company recorded an IPR&D charge of \$0.9 million for the stock issuance on June 30, 2009, as the technological feasibility associated with the IPR&D had not been established since the final prototype of the device had not been completed, and no alternative future use exists.

Table of Contents**6. Debt and Other Financing Activity*****Private Placement***

In June 2009, the Company entered into a Subscription Agreement with one of its existing shareholders, Healthpoint Capital Partners II, LP (Healthpoint). The Company sold 3,937,007 shares of its common stock at a price of \$2.54 per share in a private placement (the Placement) for an aggregate purchase price of approximately \$10.0 million. The Company paid approximately \$0.1 million for transaction fees related to the Placement and received aggregate net proceeds of approximately \$9.9 million. The Company recorded the transaction fees as a reduction to additional paid in capital.

Loan and Security Agreement

In December 2008, the Company entered into the Credit Facility with the Lenders consisting of a \$15.0 million term loan and a \$15.0 million working capital line of credit. The term loan carries a fixed interest rate of 11.25% with interest payments due monthly but no principal repayment through September 2009. Thereafter, the Company will be required to repay the principal plus interest in 30 equal monthly installments, ending in April 2012. An additional finance charge of \$0.8 million is due in April 2012. The finance charge is being accrued to interest expense through April 2012. The Company will pay a prepayment penalty if the loan is repaid prior to maturity. The Company does not currently anticipate repaying the debt early.

The working capital line of credit carries an interest rate equal to the prime rate plus either 2.5% or 2.0%, depending on the Company's financial performance. Interest-only payments are due monthly and the principal is due at maturity in April 2012. As of June 30, 2009 the Company has \$0.4 million remaining available to be drawn under the working capital line of credit.

In connection with this Credit Facility, the Company issued warrants to the Lenders to purchase an aggregate of approximately 476,000 shares of the Company's common stock. The warrants are immediately exercisable and have an exercise price of \$1.89 per share and a ten year term. The Company recorded the value of the warrants of \$0.9 million as a debt discount. The value of the warrants was determined on the date of grant using the Black-Scholes valuation method with the following assumptions: risk free interest rate of 2.67%, volatility of 60.9%, a ten year term and no dividend yield.

To secure the repayment of any amounts borrowed under this Credit Facility, the Company granted to the Lenders a first priority security interest in all of its assets, other than its owned and licensed intellectual property rights. The Company also agreed not to pledge or otherwise encumber its intellectual property assets without the consent of the Lenders.

The Company is also required to maintain compliance with financial covenants which include a minimum level of revenues and a minimum level of Adjusted EBITDA (a non-GAAP term defined as net income (loss) excluding the effects of interest, taxes, depreciation, amortization, stock-based compensation and in-process R&D). As of June 30, 2009, the Company was in compliance with the financial covenants set forth in the Credit Facility.

The Lenders have the right to declare the loan immediately due and payable in an event of default under the Credit Facility, which includes, among other things, the failure to make payments when due, breaches of representations, warranties or covenants, the occurrence of certain insolvency events, the occurrence of a non-appealable legal judgment against the Company that is not satisfied within ten days, or the occurrence of an event which, in the opinion of the Lenders, could have a material adverse effect on the Company.

During the three months ended June 30, 2009, the Company drew an additional \$1.9 million and repaid \$0.3 million on the working capital line of credit. As of June 30, 2009 the balance of the line of credit was \$14.6 million. The balance on the term loan was \$14.3 million, net of the debt discount. Amortization of the debt discount and issuance costs and accretion of the additional finance charge, which are recorded to interest expense, totaled \$0.2 million and \$0.5 million for the three and six months ended June 30, 2009, respectively. Interest expense for the Credit Facility, excluding debt discount and issuance cost amortization and accretion of the additional finance charge, totaled \$0.6 million and \$1.3 million for the three and six months ended June 30, 2009, respectively.

Other Debt Agreements

In September 2008, Alphatec Pacific paid \$0.8 million on its Resona Bank line of credit and replaced the line of credit with \$0.6 million of term debt 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, a subsidiary of Alphatec Pacific. As of June 30, 2009, the balance

of the notes and the bond totaled \$1.4 million.

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The Company has various capital lease arrangements. The leases bear interest at rates ranging from 5.52% to 7.46%, are generally due in monthly principal and interest installments, are collateralized by the related equipment, and have various maturity dates through March 2010. As of June 30, 2009, the balance of these capital leases totaled \$0.1 million.

The Company has a note payable with Microsoft, Inc. for the purchase of software licenses, bearing interest at a rate of 2.7% and a maturity date of February 2011. The balance of this note as of June 30, 2009 was \$0.3 million.

During the three months ended June 30, 2009 the Company executed financing agreements totaling \$0.3 million for the payment of premiums on a product liability insurance policy and a director and officer insurance policy as the term was expiring on each of the prior policies. The financing arrangements bear interest at 5.2% payable through June 2010. The balance of these financing agreements as of June 30, 2009 totaled \$0.2 million.

Principal payments on debt are as follows as of June 30, 2009 (in thousands):

Year Ending December 31,	
Remainder of 2009	\$ 1,473
2010	6,467
2011	6,565
2012	17,727
2013	48
Thereafter	4
Total	32,284
Less: additional finance charge being accrued to interest expense through April 2012, and debt discount	(1,410)
Add: capital lease principal payments	142
Total	31,016
Less: current portion of long-term debt	(4,439)
Long-term debt, net of current portion	\$ 26,577

7. Commitments and Contingencies

Leases

The Company leases certain equipment under capital leases which expire on various dates through 2010. The Company also leases its 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 2009	\$ 1,168	\$ 132
2010	2,802	13
2011	2,489	
2012	2,193	
2013	2,211	
Thereafter	5,829	
	\$ 16,692	145
Less: amount representing interest		(3)

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Present value of minimum lease payments	142
Current portion of capital leases	(142)
Capital leases, less current portion	\$

Rent expense under operating leases for the three months ended June 30, 2009 and 2008 was \$0.4 million and \$0.6 million, respectively. Rent expense under operating leases for the six months ended June 30, 2009 and 2008 was \$1.2 million and \$1.0 million, respectively.

Litigation

On April 12, 2006, Alphatec Spine and HealthpointCapital, L.P., the Company's majority stockholder, and its affiliate, HealthpointCapital, LLC, were served with a complaint by Drs. Darryl Brodke, Alan Hilibrand, Richard Ozuna and Jeffrey Wang, or the claimant surgeons, in the Superior Court of California in the County of Orange, claiming, among other things, that, pursuant to certain contractual arrangements Alphatec Spine allegedly entered into with the claimant surgeons in 2001, it was required to pay the claimant surgeons quarterly royalties in an aggregate amount of 6% of the net sales of polyaxial screws (as defined in the alleged contractual arrangement), which the claimant surgeons allege were developed with their assistance prior to the cessation of such development activities in March 2002. Alphatec Spine first began to sell polyaxial screws in 2004 and has continued to sell them

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through the date of this Quarterly Report on Form 10-Q. In October of 2006, the parties to this litigation initiated a mediation session in an attempt to mediate a resolution to this matter, but were unsuccessful in doing so. The claimant surgeons assert causes of action for breach of contract, fraud, conversion, breach of fiduciary duty, and unjust enrichment. In the first quarter of 2009, the claimant surgeons dismissed all claims against both HealthpointCapital entities. The fraud, conversion and breach of fiduciary duty claims were dismissed in summary judgment in the third quarter of 2009. A trial is scheduled on the remaining claims in the third quarter of 2009. Alphatec Spine does not believe that any of the claimant surgeons are entitled to any royalty amounts, has filed counterclaims against certain of the claimant surgeons, and intends to vigorously defend itself against this complaint; however, Alphatec Spine cannot predict the outcome to this matter or the impact on its financial statements, if any.

A judgment against Alphatec Spine or the Company in excess of the amount accrued and/or legal costs significantly in excess of amounts currently budgeted in the Company's operating plan may cause an acceleration of the Company's Credit Facility through a financial covenant violation or a material adverse change claim by the Lenders (See Note 6). While the outcome to the litigation is uncertain, management does not believe that the ultimate outcome of claims against the Company will result in an adverse material impact to the Company.

Royalties

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

8. Net Loss Per Share

The Company calculates net loss per share in accordance with SFAS No. 128, *Earnings 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 June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Numerator:				
Net loss	\$ (6,303)	\$ (3,591)	\$ (10,686)	\$ (19,370)
Denominator:				
Weighted average common shares outstanding	47,981	47,374	47,710	47,276
Weighted average unvested common shares subject to repurchase	(824)	(1,100)	(878)	(1,138)
Weighted average common shares outstanding - basic	47,157	46,274	46,832	46,138
Effect of dilutive securities:				
Options, warrants and restricted share awards				
Weighted average common shares outstanding - diluted	47,157	46,274	46,832	46,138
Net loss per common share:				
Basic and diluted	\$ (0.13)	\$ (0.08)	\$ (0.23)	\$ (0.42)

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

Three Months Ended June 30, Six Months Ended June 30,

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	2009	2008	2009	2008
Options to purchase common stock	2,202	1,178	2,249	1,068
Warrants to purchase common stock	476		476	
Unvested restricted share awards	926	1,202	980	1,240
Total	3,604	2,380	3,705	2,308

Table of Contents**9. Stock-Based Compensation**

The Company accounts for stock-based compensation under the provisions of SFAS No. 123(R), *Share-Based Payment*. SFAS No. 123(R) requires that share-based payment transactions with employees be recognized in the financial statements based on their fair value and recognized as compensation expense over the vesting period. The amount of expense recognized during the period is affected by many complex and subjective assumptions, including: estimates of the Company's future volatility, the expected term for its stock options, option exercise behavior, the number of options expected to ultimately vest, and the timing of vesting for the Company's share-based awards.

The Company accounts for stock option grants to non-employees in accordance with SFAS No. 123R and EITF Issue No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*, which require that the fair value of these instruments be recognized as an expense over the period in which the related services are rendered.

Under SFAS No. 123(R), share-based compensation expense of awards with performance conditions is recognized over the period from the date the performance condition is determined to be probable of occurring through the time the applicable condition is met. Determining the likelihood and timing of achieving performance conditions is a subjective judgment made by management which may affect the amount and timing of expense related to these share-based awards. Share-based compensation is adjusted to reflect the value of options which ultimately vest as such amounts become known in future periods.

Valuation of Stock Option Awards

The assumptions used to compute the share-based compensation costs for the stock options granted during the three months ended June 30, 2009 and 2008 are as follows:

	Three Months Ended June 30,	
	2009	2008
<u>Employee Stock Options</u>		
Risk-free interest rate	2.00%	3.48%
Expected dividend yield	%	%
Weighted average expected life (years)	6.2	6.2
Volatility	58%	46%

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

Compensation Costs

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Cost of revenues	\$ 51	\$ 59	\$ 103	\$ 127
Research and development	265	106	329	337
Sales and marketing	177	204	348	363
General and administrative	338	302	685	613
Total	\$ 831	\$ 671	\$ 1,465	\$ 1,440
Effect on basic and diluted net loss per share	\$ (0.02)	\$ (0.01)	\$ (0.03)	\$ (0.03)

Table of Contents**Stock Options**

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

	Shares	Weighted average exercise price	Weighted average remaining contractual term (in years)	Aggregate intrinsic value
Outstanding at December 31, 2008	2,265	\$ 4.23	8.92	\$ 97
Granted year to date	443	\$ 1.83		
Exercised year to date		\$		
Forfeited year to date	(205)	\$ 4.19		
Outstanding at June 30, 2009	2,503	\$ 3.81	8.67	\$ 834
Options vested and exercisable at June 30, 2009	1,987	\$ 3.82	8.65	\$ 653
Options vested and expected to vest at June 30, 2009	430	\$ 4.07	7.77	\$ 70

The weighted-average grant-date fair value of stock options granted during the three and six months ended June 30, 2009 was \$3.00 and \$1.83, respectively. The aggregate intrinsic value of options at June 30, 2009 is based on the Company's closing stock price on that date of \$3.32 per share.

As of June 30, 2009, there was \$4.0 million of unrecognized compensation expense for stock options and awards which is expected to be recognized on a straight-line basis over a weighted average period of approximately 2.9 years. There were no options exercised during the three and six months ended June 30, 2009. The total intrinsic value of options exercised was immaterial for the three and six months ended June 30, 2008. At June 30, 2009, approximately 1,926,000 shares of common stock remained available for issuance under the 2005 Plan.

Restricted Stock Awards

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

	Shares	Weighted average grant date fair value	Weighted average remaining recognition period (in years)	Aggregate intrinsic value
Outstanding at December 31, 2008	882	\$ 6.40	2.19	\$ 5,645
Awarded year to date	5	\$ 2.99		
Released year to date	(150)	\$ 5.76		
Forfeited year to date	(20)	\$ 9.80		
Outstanding at June 30, 2009	717	\$ 6.42	1.73	\$ 4,602

The table above does not include the 101,944 shares of restricted stock granted to Stout in March 2008. The weighted average fair value per share of awards granted during the three months ended June 30, 2009 was \$2.99. There were no restricted awards granted during the first quarter of 2009.

Warrants

In December 2008, the Company issued warrants to the Lenders in the Credit Facility to purchase 476,000 shares of the Company's common stock with an exercise price of \$1.89 per share. The warrants are immediately exercisable and have a ten year term. The Company recorded the value of the warrants of \$0.9 million as a debt discount. The value of the warrants was determined on the grant date using the Black-Scholes valuation method with the following assumptions: risk free interest rates of 2.67%, volatility of 60.9%, a ten year term and no dividends yield. All of the warrants were outstanding as of June 30, 2009.

10. Income Taxes

The Company calculates its interim tax provision in accordance with Accounting Principles Board Opinion No. 28, *Interim Financial Reporting*, and FASB Interpretation No. 18, *Accounting for Income Taxes in Interim Periods* (FIN No. 18). 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

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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 accounts for uncertain tax positions in accordance with Financial Accounting Standards Board Interpretation, or FIN, No. 48, *Accounting for Uncertainty in Income Taxes*. FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*, and prescribes a recognition threshold and measurement attributes for financial statement disclosure of tax positions taken or expected to be taken on a tax return. 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 increased \$0.2 million during the three months ended June 30, 2009. The unrecognized tax benefits at June 30, 2009 were \$2.1 million. The Company anticipates a \$0.1 million decrease to its unrecognized tax benefits within the next 12 months.

The U.S. income tax expense consists primarily of state income taxes and the tax effect of changes in deferred tax liabilities associated with tax deductible goodwill. The foreign income tax expense consists primarily of Japanese provincial and city income taxes.

During the three months ended June 30, 2009, the Company recorded a reduction to payroll taxes, included in general and administrative expense, of approximately \$0.5 million relating to the expiration of the statute of limitations for a tax contingency reserve established in 2005.

11. Segment and Geographical Information

The Company applies the provisions of SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*. SFAS No. 131 requires public companies to report financial and descriptive information about their reportable operating segments. Operating segments are defined as components of an enterprise for which separate financial information is available and evaluated regularly by the chief operating decision maker, or decision-making group, in deciding how to allocate resources and in assessing performance. The Company operates in one reportable business segment.

During the three and six months ended June 30, 2009, the Company operated in three geographic locations, the U.S., Asia and Europe. During the three and six months ended June 30, 2008, the Company operated in two geographic locations, the U.S. and Asia. The Company commenced sales in Europe in the second half of 2008. Revenues, attributed to the geographic location of the customer, were as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
United States	\$ 26,378	\$ 19,359	\$ 50,191	\$ 38,006
Asia	5,473	4,494	11,303	9,044
Europe	412		1,379	
Total consolidated revenues	\$ 32,263	\$ 23,853	\$ 62,873	\$ 47,050

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

	June 30, 2009	December 31, 2008
United States	\$ 155,836	\$ 141,658
Asia	13,213	13,890
Europe	66	
Total consolidated assets	\$ 169,115	\$ 155,548

12. Related Party Transactions

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For the six months ended June 30, 2009 and 2008, the Company incurred costs of \$0.1 million and \$0, respectively, to Foster Management Company and HealthpointCapital, LLC for travel expenses, including the use of Foster Management Company's airplane. Foster Management Company is an entity owned by John H. Foster, a member of the Company's board of directors. John H. Foster is a significant equity holder of HealthpointCapital, LLC, an affiliate of HealthpointCapital, L.P., the Company's principal stockholder. For the three months ended June 30, 2009 and 2008, the Company did not incur any such costs.

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For the three and six months ended June 30, 2009, the Company incurred costs of \$0.2 million for legal services paid on behalf of Healthpoint Capital, LLC in connection with the Brodke litigation.

In June 2009, the Company entered into a subscription agreement with Healthpoint Capital Partners II, LP. The Company sold 3,937,007 shares of its common stock at a price of \$2.54 per share in a private placement for an aggregate purchase price of approximately \$10.0 million. The Company paid approximately \$0.1 million for transaction fees and received aggregate net proceeds of approximately \$9.9 million.

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 a written 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 months ended June 30, 2009 and 2008, the Company incurred costs of \$60,000 in each period, for advisory services provided by Dr. Hochschuler. For the six months ended June 30, 2009 and 2008, the Company incurred costs of \$120,000 in each period.

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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 our Annual Report on Form 10-K for the year ending December 31, 2008, as amended.

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. Our broad product portfolio and pipeline includes a variety of spinal disorder products and systems focused on solutions addressing the cervical, thoracolumbar, intervertebral, minimally invasive, vertebral compression fracture, osteoporotic bone, and spinal stenosis markets. Our principal product offerings are focused on the market for orthopedic spinal disorder solution products, which is estimated in the U.S. to be approximately \$5.8 billion in revenue in 2008 and is expected to grow more than 10% annually over the next three years. 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 and a strong, heat resistant, radiolucent, biocompatible plastic called polyetheretherketone, or PEEK. We also sell products made of allograft, a precision-milled and processed human bone that surgeons can use in place of metal and synthetic materials. We also sell bone-grafting products that are comprised of both tissue-based 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 FDA clearance have been cleared by the FDA and these products have been used in over 10,700 and 8,600 spine disorder surgeries in 2008 and 2007, respectively. In addition to selling our products in the U.S., we also sell our products in Japan, the European Union and Hong Kong.

Although our products generally are purchased by hospitals and surgical centers, orders are typically placed at the request of surgeons who then use our products in a surgical procedure. During the three and six months ended June 30, 2009 and 2008, no single surgeon, hospital or surgical center represented greater than 10% of our consolidated revenues. Additionally, we sell a broad array of products, which diminishes our reliance on any single product or spine disorder.

In 2007, as part of our strategy to focus on disorders affecting the aging spine, we began entering into license agreements with third parties that we believe will enable us to rapidly develop and commercialize unique products for the treatment of spinal disorders that disproportionately affect the aging population. Through June 30, 2009, we licensed or acquired approximately 42 patent and patent applications from third parties. A discussion of our license agreements through December 31, 2008 may be found in Item 1 Business-Intellectual Property included in our Annual Report on Form 10-K for the year ending December 31, 2008, as amended.

To assist us in evaluating our product development strategy, we regularly monitor long-term technology trends in the spinal implant industry. Additionally, we consider the information obtained from discussions with the surgeon community and our Scientific Advisory Board in connection with the demand for our products, including potential new product launches. We also use this information to help determine our competitive position in the spinal implant industry and the capacity requirements of our manufacturing facility.

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 screw systems and complementary products, vertebral body replacement devices, plates and bone grafting materials. Our revenues are generated by our direct sales force and independent distributors. Our products are ordered directly by surgeons and shipped and billed to hospitals or surgical centers. In Japan, where orthopedic trauma surgeons also perform spine surgeries, we have sold and will continue to sell orthopedic trauma products in order to introduce our spine products to Japanese surgeons. In Europe, we use independent distributors that purchase our products and market them to their surgeon customers. As a result of offering payment terms greater than our customary U.S. business terms and operating in a new market in which we have limited prior experience, revenues for sales to our European distributors have been deferred until payments become due or cash is received.

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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, raw materials and components. Allograft product costs include the cost of procurement and processing of human tissue. We incur royalties related to technology we license from others and products developed in part by surgeons with whom we collaborate in the product development. Amortization of purchased intangibles consists of amortization of developed product technology.

Research and development. Research and development expense consists of costs associated with the design, development, testing, and enhancement of our products. Research and development costs also include 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. In-process research and development, or IPR&D, consists of acquired research and development assets that were not technologically feasible on the date we acquired worldwide licenses for technology related to spinal products and had no 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 intellectual property rights of third parties.

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

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

Litigation settlement. Litigation settlement expense consists of material settlements of lawsuits.

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

Income tax provision. Income tax expense consists primarily of state and foreign 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 assumptions 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. Management believes there have been no material changes during the three and six months ended June 30, 2009 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, 2008, as amended.

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The table below sets forth certain statements of operations data expressed as a percentage of revenues for the periods indicated. Our historical results are not necessarily indicative of the operating results that may be expected in the future.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Revenue	100.0%	100.0%	100.0%	100.0%
Cost of revenues	35.4	33.6	35.4	33.8
Gross profit	64.6	66.4	64.6	66.2
Operating expenses:				
Research and development	10.7	14.1	10.0	13.9
In-process research and development	13.9		9.2	2.8
Sales and marketing	39.7	42.2	40.7	42.9
General and administrative	17.2	24.0	18.3	24.0
Litigation settlement				23.4
Total operating expenses	81.5	80.3	78.2	107.0
Operating loss	(16.9)	(13.9)	(13.6)	(40.8)
Other income (expense):				
Interest income	0.1	0.4	0.1	0.6
Interest expense	(2.8)	(1.1)	(2.9)	(1.0)
Other income (expense), net	0.5	(0.2)	(0.2)	0.3
Total other income (expense)	(2.2)	(0.9)	(3.0)	(0.1)
Loss before taxes	(19.1)	(14.8)	(16.6)	(40.9)
Income tax provision	0.4	0.3	0.4	0.3
Net loss	(19.5)%	(15.1)%	(17.0)%	(41.2)%

Reclassification

Certain prior year balances have been reclassified in the accompanying condensed consolidated financial statements to conform to the current year presentation. In our Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2008 filed with the SEC on August 6, 2008, our operating expenses in Japan were classified as general and administrative expenses. In this Quarterly Report on Form 10-Q, we separated the Japanese sales and marketing expenses from the general and administrative expenses. This reclassification has no impact upon total operating expenses and net loss, and resulted in a reclassification of \$1.0 million of general and administrative expense to sales and marketing expense for the three months ended June 30, 2008 and \$2.0 million of general and administrative expense to sales and marketing expense for the six months ended June 30, 2008.

Three Months Ended June 30, 2009 Compared to the Three Months Ended June 30, 2008

Revenues. Revenues were \$32.3 million for the three months ended June 30, 2009 compared to \$23.9 million for the three months ended June 30, 2008, representing an increase of \$8.4 million, or 35.3%. U.S. revenues increased \$7.0 million, or 36.3%, primarily due to increased sales of our Zodiac, Novel, Trestle, Biologics and Solanas product lines. In addition, Asia revenues increased \$1.0 million, or 21.8%, due to both sales volume (\$0.6 million) and the favorable affect of foreign currency exchange rates. We commenced sales in Europe in the third quarter of 2008. We recognized revenue of \$0.4 million in European sales in the three months ended June 30, 2009.

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Cost of revenues. Cost of revenues were \$11.4 million for the three months ended June 30, 2009 compared to \$8.0 million for the three months ended June 30, 2008, representing an increase of \$3.4 million, or 42.4%. The increase was primarily due to \$1.5 million in higher product costs associated with increased revenue performance, increased royalty payments of \$0.8 million due to increased sales volume and the new royalty payments made in connection with the Biedermann/DePuy litigation settlement, as disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008, as amended, increased depreciation costs of \$0.7 million based on a larger installed surgical instruments asset base capitalized during 2009 and higher amortization expenses of \$0.4 million due to the absence of an intangible write-off that occurred in the three months ended June 30, 2008.

Gross profit. Gross profit was \$20.9 million for the three months ended June 30, 2009 compared to \$15.8 million for the three months ended June 30, 2008, representing an increase of \$5.1 million, or 31.7%. Gross margin of 64.6% of revenues for the three months ended June 30, 2009 decreased 1.8 percentage points from the three months ended June 30, 2008. The 1.8 percentage point decrease was primarily due to increased royalty payments of 0.9 percentage points, increased instrument depreciation of 1.7 percentage points, an increase of 0.9 percentage points related to amortization of intangibles, partially offset by a decrease of 1.8 percentage points related to improved manufacturing efficiencies.

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Research and development. Research and development expenses were \$3.4 million for the three months ended June 30, 2009 compared to \$3.4 million for the three months ended June 30, 2008, representing substantially no change.

In-process research and development. In-process research and development expenses were \$4.5 million for the three months ended June 30, 2009 compared to \$0 for the three months ended June 30, 2008. In the three months ended June 30, 2009, we incurred expenses of \$3.6 million related to a milestone achieved in connection with successfully meeting a development milestone involving an expandable pedicle screw (\$1.8 million in stock and \$1.8 million in cash) and \$0.9 million in non-cash costs related to our acquisition of technology related to a stand-alone anterior lumbar interbody fusion device.

Sales and marketing. Sales and marketing expenses were \$12.8 million for the three months ended June 30, 2009 compared to \$10.1 million for the three months ended June 30, 2008, representing an increase of \$2.7 million, or 27.3%. The increase was primarily due to higher commission expense of \$1.9 million due to the higher U.S. sales volume and an increase of \$0.8 million primarily in Asia as we increase our product mix towards Alphatec's spinal products.

General and administrative. General and administrative expenses were \$5.6 million for the three months ended June 30, 2009 compared to \$5.7 million for the three months ended June 30, 2008, representing a decrease of \$0.1 million, or 3.1%. The decrease was primarily related to the reduction of \$0.5 million in payroll taxes relating to the expiration of the statute of limitations for a tax contingency reserve established in 2005, less spending in finance and accounting of \$0.2 million, offset by increased legal expenses of \$0.6 million.

Interest Income. Interest income was \$0 for the three months ended June 30, 2009 compared to \$0.1 million for the three months ended June 30, 2008, representing a decrease of \$0.1 million. The decrease was primarily due to lower cash and cash equivalent balances.

Interest Expense. Interest expense was \$0.9 million for the three months ended June 30, 2009 compared to \$0.3 million for the three months ended June 30, 2008, representing an increase of \$0.6 million. The increase was primarily due to increased interest expense for our loan agreement and line of credit with Silicon Valley Bank and Oxford Finance Corporation. We repaid our line of credit with General Electric Capital Corporation in the fourth quarter of 2008.

Other income (expense), net. Other income (expense), net was \$0.2 million for the three months ended June 30, 2009 compared to \$0 for the three months ended June 30, 2008, representing an increase in income of \$0.2 million. The increase was due to greater foreign currency exchange gains realized in the second quarter of 2009 as compared t