Alphatec Holdings, Inc.
Form 10-K/A
May 18, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

Form 10-K/A

(Amendment No. 2)

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2006

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.)**
2051 Palomar Airport Road, Suite 100, Carlsbad, California	**92011**
(Address of Principal Executive Offices)	**(Zip Code)**

(760) 431-9286

(Registrant s Telephone Number, Including Area Code)

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value $0.0001 per share	The NASDAQ Stock Market LLC

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

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

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

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

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

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

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes ¨ No x

EXPLANATORY NOTE

This Amendment No. 2 on Form 10-K/A, or the Amendment, amends Alphatec Holdings, Inc. s Annual Report on Form 10-K for the fiscal year ended December 31, 2006, originally filed on April 2, 2007, or the Original Filing, and Form 10-K/A, filed on April 30, 2007. The purpose of this Amendment is to correct a scriveners error on the Balance Sheet on Page F-3. The Accumulated deficit for the period ended December 31, 2006 is ($38,681) and was erroneously reported as ($36,681). In addition, in connection with the filing of this Amendment and pursuant to the rules of the Securities and Exchange Commission, the Chief Executive Officer and the Chief Financial Officer of the Company have reissued their certifications. Accordingly, Item 15 of Part IV has also been amended to reflect the filing of such certifications.

Except as described above, no other changes have been made to the Original Filing. The Original Filing continues to speak as of the dates described in the Original Filing, and we have not updated the disclosures contained therein to reflect any events that occurred subsequent to such dates. Accordingly, this Amendment should be read in conjunction with the Company s filings made with the Securities and Exchange Commission subsequent to the filing of the Original Filing, as information in such filings may update or supersede certain information contained in this Amendment. In this Amendment, unless the context indicates otherwise, the terms Company, we, us, and our refer to Alphatec Holdings Inc. and our subsidiaries.

ALPHATEC HOLDINGS, INC.

FORM 10-K/A ANNUAL REPORT

For the Fiscal Year Ended December 31, 2006

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PART II

Item 8. Financial Statements and Supplementary Data

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

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) *The following documents are included in Item 8 to this Annual Report on Form 10-K.*

(1) Financial Statements:

(2) Financial Statement Schedules:
Required schedules have been omitted because they are either not applicable or the required information has been disclosed in the consolidated financial statements or notes thereto.

(3) Exhibit Index

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

3.1(1)	Amended and Restated Certificate of Incorporation.
3.2(2)	Restated By-laws.
4.1(3)	Form of Common Stock Certificate.
4.2(4)	Stockholders Agreement by and among the Registrant, Healthpoint Capital Partners, L.P. and the stockholders of the Registrant, dated as of March 17, 2005.
10.1(5)*	Amended and Restated 2005 Employee, Director and Consultant Stock Plan.
10.2(6)*	Form of Non-Qualified Stock Option Agreement issued under the Amended and Restated 2005 Stock Plan.
10.3(7)*	Form of Incentive Stock Option Agreement issued under the Amended and Restated 2005 Stock Plan.
10.4(8)*	Form of Restricted Stock Agreement issued under the Amended and Restated 2005 Stock Plan.
10.7(9)	Credit Agreement by and between Alphatec Spine, Inc. and Bank of the West, dated as of January 25, 2006 and amended by the First Amendment to Credit Agreement, dated as of March 7, 2006.
10.8(10)	Security Agreement by and between Alphatec Holdings, Inc. and Bank of the West, dated as of January 25, 2006.
10.9(11)	Continuing Guaranty by Alphatec Holdings, Inc. in favor of Bank of the West, dated as of January 25, 2006.
10.10(12)	Lease Agreement by and between Alphatec Spine, Inc. and El Cedro LLC, dated as of March 31, 2001, amended by the First Amendment to the Lease Agreement, dated as of February 23, 2004 and extended by the Lease Extension Agreement, dated as of April 19, 2006.
10.11(13)	Lease Agreement by and between Alphatec Spine, Inc. and Roy P. Josepho and Roberta B. Josepho, Trustees, dated as of December 11, 2003 and amended by the First Amendment to the Lease Agreement, dated as of May 1, 2006.
10.12(14)	Lease Agreement by and between Alphatec Spine, Inc. and Roger D. Anderson Trust, dated as of September 3, 2004.
10.13(15)	Sublease Agreement by and between Alphatec Spine, Inc. and K2, Inc., dated as of July 29, 2005.
10.14(16)	Sublease Agreement by and between Alphatec Spine, Inc. and K2, Inc., dated as of August 26, 2005.
10.15(17)	Supply Agreement by and between Alphatec Spine, Inc. and Invibio, Inc., dated as of October 18, 2004 and amended by Letter of Amendment in respect of the Supply Agreement, dated as of December 13, 2004.
10.16(18)	License Agreement by and between Alphatec Spine, Inc. and Cross Medical Products, Inc. dated as of April 24, 2003.
10.17(19)	Stock Purchase Agreement by and between Alphatec Spine, Inc. and Shunshiro Yoshimi, dated as of August 11, 2005.
10.18(20)	Sales Agency Agreement by and between Alphatec Spine, Inc. and Keystone Surgical, LLC, dated as of October 1, 2005.
10.19(21)	Translation of Agreement for Transfer of Business Right by K.K. Mac and K.K. Alpha Tech Pacific, dated as of August 1, 2005.

10.20(27)	Private Label Supply Agreement by and between IsoTis OrthoBiologics, Inc. and Alphatec Spine, Inc., dated as of July 1, 2006.
10.21(27)	Patent License Agreement by and between Alphatec Spine, Inc. and Scient x S.A. dated January 23, 2007.
10.22(22)*	Employment Agreement by and among Alphatec Holdings, Inc., Alphatec Spine, Inc. and M. Ross Simmonds, dated October 12, 2006.
10.23(27)*	Amended and Restated Employment Agreement among Herbert J. Bellucci, Alphatec Spine, Inc. and Alphatec Holdings, Inc., dated as of July 17, 2006.
10.24(23)*	Executive Services Agreement by and between Alphatec Spine, Inc. and Shunshiro Yoshimi, dated as of August 11, 2005.
10.25(24)*	Employment Agreement by and among Alphatec Holdings, Inc., Alphatec Spine, Inc. and Steven M. Yasbek, dated as of October 18, 2006.
10.26(27)*	Amended and Restated Employment Agreement among Alphatec Spine, Inc., Alphatec Holdings, Inc. and Steven Reinecke, dated July 17, 2006.
10.27(27)*	Employment Agreement by and among Alphatec Spine, Inc., Alphatec Holdings, Inc. and Steve Lubischer, dated November 10, 2006.
10.28(27)	Separation Agreement by and among Alphatec Spine, Inc., Alphatec Holdings, Inc. and Scott Wiese, dated December 13, 2006.
10.29(25)	Separation Agreement by and among Alphatec Holdings, Inc., Alphatec Spine, Inc. and Stephen T.D. Dixon, dated October 23, 2006.
10.30(27)*	Consulting Agreement by and among Alphatec Spine, Inc., Alphatec Holdings, Inc. and Stephen J. Hochschuler, M.D. dated October 13, 2006.
10.31(27)	Security Agreement by and between Alphatec Spine, Inc. and Bank of West, dated January 12, 2007.
10.32(27)	Fourth Amendment to Credit Agreement by and between Alphatec Spine, Inc. and Bank of the West, dated as of November 11, 2006.
10.33(27)	Sixth Amendment to Credit Agreement by and between Alphatec Spine, Inc. and Bank of the West, dated as of January 12, 2007.
10.34(27)	Seventh Amendment to Credit Agreement by and between Alphatec Spine, Inc. and Bank of the West, dated as of March 7, 2007.
10.35(27)	Fifth Amendment to Credit Agreement by and between Alphatec Spine, Inc. and Bank of the West, dated November 17, 2006.
10.36(27)	Second Amendment to Credit Agreement by and between Alphatec Spine, Inc. and Bank of the West, dated April 26, 2006.
10.37(27)	Third Amendment to Credit Agreement by and between Alphatec Spine, Inc. and Bank of the West, dated June 27, 2006.
21.1(26)	List of subsidiaries of the Registrant
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. 1350 and Section 906 of the Sarbanes-Oxley Act of 2002.

* Management contract or compensatory plan or arrangement.

Confidential treatment has been requested with respect to portions of this document

1 Incorporated by reference from Exhibit 3.2 to the Registration Statement on Form S-1, as amended (Registration No. 333-131609), filed on April 20, 2006.

2 Incorporated by reference from Exhibit 3.4 to the Registration Statement on Form S-1, as amended (Registration No. 333-131609), filed on May 26, 2006.

3 Incorporated by reference from Exhibit 4.1 to the Registration Statement on Form S-1, as amended (Registration No. 333-131609), filed on May 26, 2006.

4 Incorporated by reference from Exhibit 4.2 to the Registration Statement on Form S-1, as amended (Registration No. 333-131609), filed on February 6, 2006.

5 Incorporated by reference from Exhibit 10.5 to the Registration Statement on Form S-1, as amended (Registration No. 333-131609), filed on May 26, 2006.

6 Incorporated by reference from Exhibit 10.6 to the Registration Statement on Form S-1, as amended (Registration No. 333-131609), filed on April 20, 2006.

7 Incorporated by reference from Exhibit 10.7 to the Registration Statement on Form S-1, as amended (Registration No. 333-131609), filed on April 20, 2006.

8 Incorporated by reference from Exhibit 10.8 to the Registration Statement on Form S-1, as amended (Registration No. 333-131609), filed on April 20, 2006.

9 Incorporated by reference from Exhibit 10.16 to the Registration Statement on Form S-1, as amended (Registration No. 333-131609), filed on February 6, 2006.

10 Incorporated by reference from Exhibit 10.17 to the Registration Statement on Form S-1, as amended (Registration No. 333-131609), filed on February 6, 2006.

11 Incorporated by reference from Exhibit 10.18 to the Registration Statement on Form S-1, as amended (Registration No. 333-131609), filed on February 6, 2006.

12 Incorporated by reference from Exhibit 10.20 to the Registration Statement on Form S-1, as amended (Registration No. 333-131609), filed on February 6, 2006.

13 Incorporated by reference from Exhibit 10.21 to the Registration Statement on Form S-1, as amended (Registration No. 333-131609), filed on February 6, 2006.

14 Incorporated by reference from Exhibit 10.22 to the Registration Statement on Form S-1, as amended (Registration No. 333-131609), filed on February 6, 2006.

15 Incorporated by reference from Exhibit 10.23 to the Registration Statement on Form S-1, as amended (Registration No. 333-131609), filed on February 6, 2006.

16 Incorporated by reference from Exhibit 10.24 to the Registration Statement on Form S-1, as amended (Registration No. 333-131609), filed on February 6, 2006.

17 Incorporated by reference from Exhibit 10.29 to the Registration Statement on Form S-1, as amended (Registration No. 333-131609), filed with the Securities and Exchange Commission on April 19, 2006.

18 Incorporated by reference from Exhibit 10.26 to the Registration Statement on Form S-1, as amended (Registration No. 333-131609), filed with the Securities and Exchange Commission on March 23, 2006

19 Incorporated by reference from Exhibit 10.27 to the Registration Statement on Form S-1, as amended (Registration No. 333-131609), filed on February 6, 2006.

20 Incorporated by reference from Exhibit 10.31 Registration Statement on Form S-1, as amended (Registration No. 333-131609), filed with the Securities and Exchange Commission on March 23, 2006

21 Incorporated by reference from Exhibit 10.32 to the Registration Statement on Form S-1, as amended (Registration No. 333-131609), filed with the Securities and Exchange Commission on March 23, 2006

22 Incorporated by reference from Exhibit 10.1 to the Current Report on Form 8-K on October 18, 2006.

23 Incorporated by reference from Exhibit 10.15 to the Registration Statement on Form S-1, as amended (Registration No. 333-131609), filed on February 6, 2006.

24 Incorporated by reference from Exhibit 10.2 to the Current Report on Form 8-K on October 23, 2006.

25 Incorporated by reference from Exhibit 10.1 to the Current Report on Form 8-K on October 23, 2006.

26 Incorporated by reference from Exhibit 21.1 to the Registration Statement on Form S-1, as amended (Registration No. 333-131609), filed on February 6, 2006.

27 Incorporated by reference from Form 10-K on April 2, 2007.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this Annual Report on Form 10-K/A to be signed on its behalf by the undersigned, thereunto duly authorized.

ALPHATEC HOLDINGS, INC.

Dated: May 18, 2007	By:	/s/ STEVEN M. YASBEK
	Name:	**Steven M. Yasbek**
	Title:	**Chief Financial Officer, Vice President and Treasurer**

ALPHATEC HOLDINGS, INC.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders

Alphatec Holdings, Inc.

We have audited the accompanying consolidated balance sheets of Alphatec Holdings, Inc. (the Successor) as of December 31, 2006 and 2005, and the related consolidated statements of operations, stockholders equity (deficit) and cash flows for the year ended December 31, 2006 and for the period from March 18, 2005 through December 31, 2005. We have also audited the accompanying consolidated statements of operations, stockholders equity and cash flows of Alphatec Manufacturing, Inc., (the Predecessor) for the period from January 1, 2005 through March 17, 2005 and for the year ended December 31, 2004. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company s internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Successor at December 31, 2006 and 2005, and the consolidated results of its operations and its cash flows for the year ended December 31, 2006 and for the period March 18, 2005 through December 31, 2005 and the consolidated results of operations and cash flows of the Predecessor for the period from January 1, 2005 through March 17, 2005 and for the year ended December 31, 2004 in conformity with generally accepted accounting principles in the United States.

As discussed in Note 1 to the consolidated financial statements, effective January 1, 2006, Alphatec Holdings, Inc. changed its method of accounting for share-based payments in accordance with Statement of Financial Accounting Standards No. 123(R) (Revised 2004).

/s/ Ernst & Young LLP

San Diego, California

March 28, 2007

ALPHATEC HOLDINGS, INC.

BALANCE SHEETS

	December 31, 2006	December 31, 2005
	(In thousands, except par value data)	
Assets		
Current assets:		
Cash and cash equivalents	$ 16,943	$ 2,180
Restricted cash	1,100	
Accounts receivable, net	10,583	9,361
Inventories, net	13,454	8,458
Prepaid expenses and other current assets	2,234	1,050
Deferred income tax asset	1,184	3,057
Total current assets	45,498	24,106
Property and equipment, net	12,583	7,206
Goodwill	60,389	60,946
Intangibles, net	10,185	13,644
Other assets	622	3,237
Total assets	$ 129,277	$ 109,139
Liabilities and Stockholders Equity (Deficit)		
Current liabilities:		
Accounts payable	$ 5,798	$ 4,103
Accrued expenses	10,369	8,832
Lines of credit	3,163	3,942
Current portion of long-term debt	2,060	1,280
Current portion of note payable to related party		1,700
Total current liabilities	21,390	19,857
Long-term debt, less current portion	3,111	1,728
Note payable to related party, less current portion		781
Other long-term liabilities	1,886	1,711
Deferred income tax liabilities	1,467	3,057
Commitments and contingencies		
Minority interest	2,724	1,914
Redeemable convertible preferred, Rolling common and Series C common stock, $0.0001 par value; 10,929 shares authorized at December 31, 2005; no shares and 8,773 shares issued and outstanding at December 31, 2006 and December 31, 2005, respectively		99,348
New Redeemable preferred stock, $0.0001 par value; 20,000 authorized at December 31, 2006; 3,333 and no shares issued and outstanding at December 31, 2006 and December 31, 2005, respectively	23,703	
Stockholders equity (deficit):		
Common stock, $0.0001 par value; 200,000 and 70,848 shares authorized; 34,774 and 20,602 shares issued and outstanding at December 31, 2006 and December 31, 2005, respectively	3	1
Additional paid-in capital	113,563	12,016
Deferred compensation		(18,296)
Accumulated other comprehensive income (loss)	111	(113)
Accumulated deficit	(38,681)	(12,865)
Total stockholders equity (deficit)	74,996	(19,257)
Total liabilities and stockholders equity (deficit)	$ 129,277	$ 109,139

See accompanying notes.

ALPHATEC HOLDINGS, INC.

STATEMENTS OF OPERATIONS

	Successor Year ended December 31, 2006	Successor March 18, 2005 to December 31, 2005	Predecessor January 1, 2005 to March 17, 2005	Predecessor Year ended December 31, 2004
	(In thousands, except per share amounts)			
Revenues	$ 74,005	$ 36,276	$ 6,050	$ 17,821
Cost of revenues	25,700	16,040	1,682	5,460
Gross profit	48,305	20,236	4,368	12,361
Operating expenses:				
Research and development	3,589	751	216	1,177
In-process research and development		3,100		
Sales and marketing	33,099	15,031	3,037	5,064
General and administrative	33,731	15,321	2,191	5,942
Total operating expenses	70,419	34,203	5,444	12,183
Operating income (loss)	(22,114)	(13,967)	(1,076)	178
Other income (expense):				
Interest income	701	129		
Interest expense	(2,128)	(1,942)	(116)	(312)
Failed acquisition costs	(1,967)			
Other income (expense), net	(38)	(124)	5	739
Total other income (expense)	(3,432)	(1,937)	(111)	427
Income (loss) before tax	(25,546)	(15,904)	(1,187)	605
Income tax (benefit) provision	270	(3,039)	2	96
Net income (loss)	(25,816)	(12,865)	(1,189)	509
Accretion to redemption value of redeemable convertible preferred stock, Rolling common and Series C common stock	(3,450)	(7,601)		
Net income (loss) available to common stockholders	$ (29,266)	$ (20,466)	$ (1,189)	$ 509
Net income (loss) per common share:				
Basic	$ (1.07)	$ (1.12)	$ (0.13)	$ 0.06
Diluted	$ (1.07)	$ (1.12)	$ (0.13)	$ 0.05
Weighted-average shares used in computing net income (loss) per share:				
Basic	27,238	18,201	9,211	9,179
Diluted	27,238	18,201	9,211	9,620

See accompanying notes.

ALPHATEC HOLDINGS, INC.

STATEMENTS OF STOCKHOLDERS EQUITY

	Common stock							
	Shares	**Amount**	**Additional paid-in capital**	**Deferred compensation**	**Notes receivable from stockholders**	**Accumulated other comprehensive income (loss)**	**Accumulated deficit**	**Total stockholders equity (deficit)**
				(In thousands)				
Predecessor:								
Balance at December 31, 2003	9,403	$ 94	$ 6,778		$ (215)	$ (136)	$ (5,523)	$ 998
Issuance of common stock	10		10					10
Reacquisition of common stock	(178)	(2)	(160)		162			
Repayment of notes receivable from stockholders and related stock-based compensation expense			92		16			108
Deferred employee stock-based compensation			1,326	(1,326)				
Amortization of deferred employee stock-based compensation				187				187
Comprehensive loss:								
Foreign currency translation adjustments						16		16
Net loss							509	509
Total comprehensive loss								525
Balance at December 31, 2004	9,235	92	8,046	(1,139)	(37)	(120)	(5,014)	1,828
Reacquisition of common stock	(10)		(9)		9			
Repayment of notes receivable from stockholders and related stock-based compensation expense			189		2			191
Stock-based compensation related to sale of stock to employees			832					832
Amortization of deferred employee stock-based compensation				1,139				1,139
Comprehensive loss:								
Foreign currency translation adjustments						(4)		(4)
Net loss							(1,189)	(1,189)
Total comprehensive loss								(1,193)
Balance at March 17, 2005	9,225	$ 92	$ 9,058	$	$ (26)	$ (124)	$ (6,203)	$ 2,797

See accompanying notes.

ALPHATEC HOLDINGS, INC.

STATEMENTS OF STOCKHOLDERS EQUITY (Continued)

	Common stock						
	Shares	**Amount**	**Additional paid-in capital**	**Deferred compensation**	**Accumulated other comprehensive income (loss)**	**Accumulated deficit**	**Total stockholders equity (deficit)**
				(In thousands)			
Successor:							
Issuance of restricted stock, net of repurchases	1,985	$	$	$	$	$	$
Issuance of common stock in connection with preferred stock sale	18,617	1	(1)				
Deferred employee stock-based compensation			20,531	(20,531)			
Cancellation of deferred employee stock-based compensation			(952)	953			1
Amortization of deferred employee stock-based compensation				1,282			1,282
Non-employee stock-based compensation			39				39
Accretion to redemption value of redeemable convertible preferred, Rolling common and Series C common			(7,601)				(7,601)
Comprehensive loss:							
Foreign currency translation adjustments					(113)		(113)
Net loss						(12,865)	(12,865)
Total comprehensive loss							(12,978)
Balance at December 31, 2005	20,602	1	12,016	(18,296)	(113)	(12,865)	(19,257)
Reversal of deferred compensation balance required with the adoption of SFAS No. 123(R)			(18,296)	18,296			
Exercise of stock options	1						
Stock-based compensation			8,828				8,828
Repurchase of common stock from employees	(248)						
Accretion to redemption value of redeemable convertible preferred, Rolling common and Series C common and dividend in kind	1,482		(3,450)				(3,450)
Series B stock dividend	1						
Record issuance of new common for redemption	3,636		44,238				44,238
Net proceeds from initial public offering, net of offering costs	9,300	2	70,237				70,239
Other			(10)				(10)
Comprehensive loss:							
Foreign currency translation adjustments					224		224
Net loss						(25,816)	(25,816)
Total comprehensive loss							(25,592)
Balance at December 31, 2006	34,774	$ 3	$ 113,563	$	$ 111	$ (38,681)	$ 74,996

See accompanying notes.

ALPHATEC HOLDINGS, INC.

STATEMENTS OF CASH FLOWS

(In thousands)

	Successor Year ended December 31, 2006	Successor March 18, 2005 to December 31, 2005	Predecessor January 1, 2005 to March 17, 2005	Predecessor Year ended December 31, 2004
		(In thousands)		
Operating activities:				
Net income (loss)	$ (25,816)	$ (12,865)	$ (1,189)	$ 509
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:				
Depreciation and amortization	7,743	3,381	159	634
Stock-based compensation	8,828	1,322	2,160	280
Write-off of purchased in-process research and development		3,100		
Interest expense related to amortization of debt discount and revaluation of put right	1,272	1,452		
Deferred income taxes	285	(3,075)		
Changes in operating assets and liabilities:				
Accounts receivable	(1,272)	(3,026)	(1,401)	(1,367)
Inventories	(4,554)	430	(84)	(742)
Prepaid expenses and other current assets	(1,268)	(265)	(241)	(27)
Income taxes receivable	71	(17)		19
Other assets	2,611	(197)	6	13
Accounts payable	1,722	(402)	86	965
Accrued expenses and other	1,785	2,128	298	998
Net cash (used in) provided by operating activities	(8,593)	(8,034)	(206)	1,282
Investing activities:				
Acquisition of Alphatec Manufacturing, Inc., net of cash acquired	(5)	(69,990)		
Acquisition of certain assets and liabilities of Cortek, Inc., net of cash acquired	54	(7,398)		
Acquisition of Ishibe Medical Co. Ltd, net of cash acquired		651		
Purchases of instruments, property and equipment	(9,702)	(4,198)	(60)	(598)
Investment in Certificate of Deposit	(1,100)			
Net cash used in investing activities	(10,753)	(80,935)	(60)	(598)
Financing activities:				
Net proceeds from issuance of common stock	70,239			10
Proceeds from issuance of Rolling common, Series C common and preferred stock	221	91,609		
Borrowings (repayments) under lines of credit	(755)	3,079		
Principal payments on capital lease obligations	(669)	(579)	(155)	(522)
Proceeds from issuance of notes payable	4,629	1,192		1,293
Principal payments on notes payable	(4,729)	(2,944)	(80)	(613)
Deferred Costs paid in connection with initial public offering		(1,195)		
Repayment of supply agreement obligation	(75)	(75)		(75)
Stock redemption	(35,153)			
Repayment of stockholder notes receivable	65	139	2	17
Net cash provided by (used in) financing activities	33,773	91,226	(233)	110

Effect of exchange rate changes on cash and cash equivalents	336	(77)	(2)	9
Net increase (decrease) in cash and cash equivalents	14,763	2,180	(501)	803
Cash and cash equivalents at beginning of period	2,180		1,557	754
Cash and cash equivalents at end of period	$ 16,943	$ 2,180	$ 1,056	$ 1,557

See accompanying notes.

ALPHATEC HOLDINGS, INC.

STATEMENTS OF CASH FLOWS (Continued)

	Successor Year ended December 31, 2006	Successor March 18, 2005 to December 31, 2005	Predecessor January 1, 2005 to March 17, 2005	Predecessor Year ended December 31, 2004
		(In thousands)		
Supplemental disclosure of cash flow information:				
Cash paid for interest	$ 658	$ 431	$ 102	$ 268
Accretion to redemption value of redeemable stock	$ 3,450	$ 7,601	$	$
Repurchase of distribution rights	$	$ 3,098	$	$
Revaluation of put right (Minority interest)	$ (810)	$ 598	$	$
Purchases of property and equipment through capital leases	$ 46	$ 246	$	$ 1,921
Issuance (forgiveness) of notes receivable from stockholders	$ (10)	$ 204	$ (9)	$ (162)
Issuance of supply agreement obligation	$	$	$	$ 225

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ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization, Basis of Presentation and Summary of Significant Accounting Policies

The Company

Alphatec Holdings, Inc. (Alphatec, the Successor or the Company) was incorporated in the state of Delaware in March 2005 in order to acquire 100% of the outstanding common stock of the Predecessor (as hereinafter defined) on March 18, 2005, as more fully described in Note 2.

Alphatec Spine, Inc., formerly known as Alphatec Manufacturing, Inc., (the Predecessor), is a California corporation organized in May 1990 and is primarily engaged in the development, manufacturing, and sale of medical devices for use in orthopedic trauma, spinal, and reconstructive surgeries. The Predecessor s principal operating activities are conducted through Alphatec Spine, Inc. and its consolidated subsidiaries, Nexmed, Inc. (Nexmed), a California corporation, Alphatec Pacific, Inc. (Alphatec Pacific), a Japanese corporation, and Milverton Limited (Milverton), a Hong Kong corporation.

Basis of Presentation

The consolidated financial statements of the Predecessor include the accounts of Alphatec Spine, Inc. and its wholly owned subsidiaries, Alphatec Pacific, Milverton and Nexmed.

The consolidated financial statements of the Successor include the accounts of Alphatec and Alphatec Spine, Inc. and its wholly owned subsidiaries, Nexmed and Milverton and its 80% owned subsidiary, Alphatec Pacific. Intercompany balances and transactions have been eliminated in consolidation.

The consolidated statement of operations for the period from March 18, 2005 to December 31, 2005 includes the results of the Cortek business from the beginning of the accounting period nearest to its acquisition date (September 9, 2005). See Note 2.

Nexmed did not have significant activity during any of the periods presented.

On May 3, 2006, the Company s board of directors approved a 3.57-for-1 stock split in the form of a dividend of 2.57 shares of the Company s outstanding common stock. The accompanying consolidated financial statements of the successor and these notes give retroactive effect to the stock split for all periods presented. This resulted in the issuance of 15.5 million shares of additional common stock to the Company s common stockholders.

Foreign Currency Translation and Transactions

The Company s primary functional currency is the U.S. dollar, while the functional currency of the Company s Japanese and Hong Kong subsidiaries is the Japanese yen and the Hong Kong dollar, respectively. Assets and liabilities denominated in foreign currencies are translated at the rate of exchange on the balance sheet date. Revenues and expenses are translated using the average exchange rate for the period. Gains and losses on foreign currency transactions are recognized as incurred.

Use of Estimates

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

ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Fair Value of Financial Instruments

The carrying value of accounts receivable, 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.

Concentration of Credit Risk and Significant Customers

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist primarily of cash and cash equivalents and accounts receivable. The Company limits its exposure to credit loss by depositing its cash and cash equivalents with high credit quality financial institutions.

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

Revenue Recognition

The Company recognizes revenue when all four of the following criteria are met: (i) persuasive evidence that an arrangement exists; (ii) delivery of the products has occurred; (iii) the selling price is fixed or determinable; and (iv) collectibility is reasonably assured. In addition, the Company follows the provisions of Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition* , which sets forth guidelines for the timing of revenue recognition based upon factors such as passage of title, installation, payment and customer acceptance.

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

Impairment of Long-Lived Assets

In accordance with Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* , if indicators of impairment exist, the Company assesses the recoverability of the affected long-lived assets by determining whether the carrying value of such assets can be recovered through undiscounted future operating cash flows. If impairment is indicated, the Company measures the amount of such impairment by comparing the carrying value of the asset to the undiscounted cash flows associated with the use of the asset. The Company believes the future cash flows to be received from the long-lived assets will exceed the assets carrying value, and accordingly the Company has not recognized any impairment losses through December 31, 2006 .

Cash and Cash Equivalents

The Company considers all investments with an original maturity of three months or less when purchased to be cash equivalents. Cash equivalents primarily represent funds invested in money market funds, whose cost equals fair market value.

Restricted Cash

The Company has certificate of deposits with Bank of the West as collateral for the one standby letter of credit issued to secure the lines of credit for Alphatec Pacific and Milverton with Resona Bank.

ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Accounts Receivable and Allowance for Doubtful Accounts

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

Inventories

Inventories are stated at the lower of average cost or market and include material, labor and overhead costs. The Company reviews the components of its inventory on a quarterly periodic basis for excess, obsolete and impaired inventory, based upon historical turnover and assumptions about future demand for our products and market conditions. Our allograft implants have up to a four-year shelf life and are subject to demand fluctuations based on the availability and demand for alternative implant products. Our estimates and assumptions for excess and obsolete inventory are reviewed and updated on a quarterly basis. The estimates we use for demand are also used for near-term capacity planning and inventory purchasing and are consistent with our revenue forecasts. Increases in the reserve for excess and obsolete inventory result in a corresponding expense to cost of goods sold.

A stated goal of our business is to focus on continual product innovation and to obsolete our own products. While we believe this provides a competitive edge, it also results in the risk that our products and related capital instruments will become obsolete prior to the end of their anticipated useful lives. If we introduce new products or next-generation products prior to the end of the useful life of a prior generation, we may be required to dispose of existing inventory and related capital instruments and/or write off the value or accelerate the depreciation of the these assets. We have not recorded excess and obsolescence expenses related to the introduction of next generation products.

Property and Equipment

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

During the fourth quarter of 2005, management reviewed its use of surgical instruments and concluded that it should reduce the depreciable life of surgical instruments from three to two years. The results of operations for the fourth quarter of 2005 include approximately $0.1 million of additional depreciation resulting from this reduction in the estimated life of surgical instruments.

Goodwill and Other Intangible Assets

SFAS No. 142, *Goodwill and Other Intangible Assets* , requires goodwill to be tested for impairment on an annual basis and between annual tests in certain circumstances, and written down when impaired. Furthermore, SFAS No. 142 requires purchased intangible assets other than goodwill to be amortized over their useful lives unless these lives are determined to be indefinite.

ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company is amortizing its intangible assets, other than goodwill, on a straight-line basis over a three to ten-year period. No amortization of goodwill has been recorded. Instead, the Company performs an impairment assessment by applying a fair-value based test in the fourth quarter of each year, or more frequently if changes in circumstances or the occurrence of events suggest the remaining value is not recoverable. The Company has not recognized any impairment losses through December 31, 2006.

Other Assets

As of December 31, 2005, other assets consisted of costs incurred in connection with the Company s initial public offering that were reclassified to stockholders equity and netted against the gross proceeds of the offering in June 2006 when the initial public offering was completed.

Other Long-term Liabilities

Other long-term liabilities consist of accruals for potential payroll withholding, property and sales taxes and the long-term portion of severance payable.

Research and Development

Research and development expenses consist of costs incurred to further the Company s research and development activities and are expensed as incurred.

Product Shipment Cost

Product shipment costs are included in sales and marketing expense in the accompanying consolidated statements of operations.

Advertising Costs

Advertising costs are expensed as incurred. Total advertising costs for any of the periods presented in our accompanying statements of operations were not significant.

Income Taxes

In accordance with SFAS No. 109, *Accounting for Income Taxes* , a deferred tax asset or liability is determined based on the difference between the financial statement and tax bases of assets and liabilities as measured by the enacted tax rates which will be in effect when these differences reverse. The Company provides a valuation allowance against net deferred tax assets unless, based upon the available evidence, it is more likely than not that the deferred tax assets will be realized. Deferred tax liabilities associated with goodwill that is amortizable for tax purposes cannot be considered a source of taxable income to support the realization of deferred tax assets because these deferred tax liabilities will not reverse until some indefinite future period.

Stock-Based Compensation

Effective January 1, 2006, the Company adopted the provisions of SFAS No. 123(R), *Share-Based Payment* using the prospective transition method and therefore, prior period results were not restated. SFAS No. 123(R) supersedes Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock issued to Employees* , and related interpretations, and revises

ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

guidance in SFAS No. 123, *Accounting for Stock-Based Compensation* . Under this transition method, the compensation cost related to all equity instruments granted prior to, but not yet vested as of, the adoption date is recognized based on the grant-date fair value which is estimated in accordance with the original provisions of SFAS No. 123. Compensation costs related to all equity instruments granted after January 1, 2006 is recognized at grant-date fair value of the awards in accordance with the provisions of SFAS No. 123(R). Additionally, under the provisions of SFAS No. 123(R), the Company is required to include an estimate of the number of the awards that will be forfeited in calculating compensation costs, which is recognized over the requisite service period of the awards on a straight-line basis.

Valuation of Stock Option Awards

The weighted average grant-date fair value of stock options granted during the year ended December 31, 2006 was $5.60. The assumptions used to compute the share-based compensation costs for the stock options granted during the year ended December 31, 2006 are as follows:

Employee Stock Options	
Risk-free interest rate	4.535 4.675 %
Expected dividend yield	0%
Weighted average expected life (years)	6.5
Volatility	62 65%
Forfeiture rate	15%

The risk-free interest rate assumption was based on the United States Treasury s rates for U.S. Treasury zero-coupon bonds with maturities similar to those of the expected term of the award being valued. The assumed dividend yield was based on the Company s expectation of not paying dividends in the foreseeable future. The weighted average expected life of options was calculated using the simplified method as prescribed by SAB No. 107. This decision was based on the lack of relevant historical data due to the Company s limited historical experience. In addition, due to the Company s limited historical data, the estimated volatility also reflects the application of SAB No. 107, incorporating the historical volatility of comparable companies whose share prices are publicly available.

Compensation Costs

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

	Successor Year Ended December 31, 2006	Successor March 18, 2005 to December 31, 2005	Predecessor January 1, 2005 to March 17, 2005	Predecessor Year Ended December 31, 2004
Cost of revenues	$ 779	$ 106	$	$
Research and development	304	53	37	7
Sales and marketing	1,340	294	980	75
General and administrative	6,405	869	1,143	198
Total	$ 8,828	$ 1,322	$ 2,160	$ 280
Effect on basic and diluted net loss per share	$ (0.32)	$ (0.07)	$ (0.23)	$ 0.03

ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

As of December 31, 2006, there was $7.1 million of unrecognized compensation expense for stock options and awards which is expected to be recognized over a weighted-average period of approximately 2.6 years. The total intrinsic value of options exercised was immaterial for the years ended December 31, 2006, 2005 and 2004.

Adjusted Net Loss Information

Prior to the adoption of SFAS No. 123(R), the Company presented deferred compensation as a separate component of stockholders equity. In accordance with the provisions of SFAS No. 123(R), on January 1, 2006, the Company reversed deferred compensation against additional paid-in capital. In addition, prior to January 1, 2006, the Company applied the intrinsic-value-based method of accounting prescribed by APB Opinion No. 25, and related interpretations, to account for its equity-based awards to employees and directors. Under this method, if the exercise price of the award equaled or exceeded the fair value of the underlying stock on the measurement date, no compensation expense was recognized. The measurement date was the date on which the final number of shares and exercise price were known and was generally the grant date for awards to employees and directors. If the exercise price of the award was below the fair value of the underlying stock on the measurement date, then compensation cost was recorded, using the intrinsic-value method, and was generally recognized in the statements of operations over the vesting period of the award.

SFAS No. 123 requires disclosure of pro forma information assuming use of the fair value method for reporting periods prior to January 1, 2006. The pro forma information is not included herein for any periods since difference between the intrinsic-value-based method and the fair value method was not material.

The fair value under SFAS No. 123 was estimated at the date of grant using the Minimum Value pricing model with the following weighted average assumptions:

	Year Ended December 31, 2004
Dividend yield	0%
Risk-free interest rate	3.50%
Volatility	0%
Expected life	5 years

No weighted average assumptions are listed for the period from January 1, 2005 to March 17, 2005 due to the fact that no equity instruments were issued during that period. Furthermore, no weighted average assumptions are listed for the period from March 18, 2005 to December 31, 2005 since no significant equity instruments issued to employees during the period were issued with exercise prices greater than $0.002, and as such, use of the Minimum Value pricing model did not result in significant additional stock-based compensation expense over the amount recorded based upon intrinsic value.

The Predecessor issued 674,000 employee equity awards in 2004. The weighted average grant date fair value of these awards was $2.21.

Equity instruments issued to non-employees are recorded at their fair value as determined in accordance with SFAS No. 123 and Emerging Issues Task Force (EITF) Issue No. 96-18, *Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods and Services* , and are periodically revalued as the equity instruments vest and are

ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

recognized as expense over the related service period. In connection with the sale of 120,487 shares of common stock to non-employees during the period from March 18, 2005 to December 31, 2005, the Company recorded total stock-based compensation within stockholders equity of $39,000.

Deferred Stock-Based Compensation Prior to 2006

The Predecessor, as a result of the valuation utilized in its merger with the Successor in March 2005, reassessed the fair value of the common stock used to grant equity awards for the period from January 1, 2004 to March 17, 2005. In determining the fair value of the Predecessor s common stock, the Board of Directors considered, among other factors, (i) the advancement of the Company s technology, (ii) the Company s financial position, (iii) industry specific and general market conditions and (iv) the enterprise valuation utilized in the merger with the Successor.

On October 19, 2005, the Successor commenced the initial public offering process and, based on the estimated valuation of the Company presented by investment bankers, reassessed the fair value of the common stock used to grant equity awards going back to March 18, 2005. Upon formation of the Successor in March 2005, the common stock was valued at zero since the Company had not yet commenced its intended operations via the acquisition of the Predecessor and the redemption value of the preferred stock sold with the common stock was equal to the purchase price of the preferred stock and common stock together. Investment bankers were valuing the Company based on its ability to increase sales consistently over prior periods since the date of acquisition and forecasted revenues which demonstrated continued growth. The Company increased the valuation of the common stock on a straight-line basis from zero on March 18, 2005 to $13.45 on October 19, 2005 since no significant positive or negative events occurred during this period, other than progressive growth in revenues, which would indicate other than a linear increase in the reassessed valuation of the common stock. The value of $13.45 on October 19, 2005 represented the low end of the valuation presented by the investment bankers at that time. Management, all of whom are related parties, completed the reassessment without the use of an unrelated valuation specialist and concluded that the stock options granted and restricted shares sold to employees were granted and sold at prices that were below the reassessed fair value.

In connection with the grant of equity awards to employees during the year ended December 31, 2004, the Predecessor recorded total deferred employee stock-based compensation within stockholders equity of $1.3 million, which represents the difference between the weighted average exercise price of $1.50 and the reassessed weighted average fair value of $3.47 on the 674,000 stock options granted. The deferred employee stock-based compensation was amortized over the vesting period of the applicable options on a straight-line basis until March 17, 2005, at which time the remaining $1.1 million of unamortized stock-based compensation was charged to expense when the change in control provisions of the options caused the options to become fully vested.

In connection with the grant of equity awards to employees during the period from March 18, 2005 to December 31, 2005, the Successor recorded total deferred employee stock-based compensation within stockholders equity of $20.5 million, which represented the difference between the exercise price and the reassessed fair value of 122,297 stock options granted and 1,937,439 restricted shares sold.

Net Loss Per Share

The Company calculated 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

ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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.

	Successor Year ended December 31, 2006	Successor March 18, 2005 to December 31, 2005	Predecessor January 1, 2005 to March 17, 2005	Predecessor Year Ended December 31, 2004
	(In thousands, except per share amounts)			
Numerator:				
Net income (loss) available to common stockholders	$ (29,266)	$ (20,466)	$ (1,189)	$ 509
Denominator:				
Weighted average common shares outstanding	28,776	19,044	9,231	9,319
Weighted average unvested common shares subject to repurchase	(1,538)	(843)		
Vested common shares outstanding purchased with promissory notes and subject to variable accounting			(20)	(140)
Weighted average common shares outstanding basic	27,238	18,201	9,211	9,179
Effect of dilutive securities:				
Options				441
Weighted average common shares outstanding diluted	27,238	18,201	9,211	9,620
Net income (loss) per common share:				
Basic	$ (1.07)	$ (1.12)	$ (0.13)	$ 0.06
Diluted	$ (1.07)	$ (1.12)	$ (0.13)	$ 0.05

As of December 31, 2006, none of the outstanding preferred stock is convertible to common stock. As of December 31, 2005, assuming all the outstanding preferred stock was converted to common stock, 7,174,504 shares would be excluded from the basic and diluted earnings per share calculations because of their anti-dilutive effect.

Segment 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. The Company identifies its operating segments based on how management internally evaluates separate financial information, business activities and management responsibility. The Company believes it operates in a single business segment.

ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the years ended December 31, 2006 and 2005, the Company had no single surgeon, hospital, or surgical center representing greater than 10% of consolidated revenues.

During the years ended December 31, 2006 and 2005, the Company operated in two geographic locations, the United States and Asia. Net revenues, attributed to the geographic location of the customer, were as follows (in thousands):

	Successor Year Ended December 31, 2006	Successor March 18, 2005 to December 31, 2005	Predecessor January 1, 2005 to March 17, 2005	Predecessor Year Ended December 31, 2004
United States	$ 60,591	$ 33,233	$ 5,495	$ 14,182
Asia	13,414	3,043	555	3,639
Total consolidated revenues	$ 74,005	$ 36,276	$ 6,050	$ 17,821

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

	December 31, 2006	December 31, 2005
United States	$ 120,584	$ 100,782
Asia	8,693	8,357
Total consolidated assets	$ 129,277	$ 109,139

Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* , which defines fair value, establishes a framework for measuring fair value in GAAP and expands disclosures about fair value measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, SFAS No. 157 does not require any new fair value measurements, but may change current practice for some entities. SFAS No. 157 is effective for fiscal years beginning after December 15, 2006. The Company does not anticipate that SFAS No. 157 will have a material effect on its consolidated financial statements.

In September 2006, the SEC issued SAB No. 108, *Considering the Effects on Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements.* SAB No. 108 requires registrants to quantify errors using both the income statement method (i.e. iron curtain method) and the rollover method and requires adjustment if either method indicates a material error. If a correction in the current year relating to prior year errors is material to the current year, then the prior year financial information needs to be corrected. A correction to the prior year results that are not material to those years would not require a restatement process where prior financials would be amended. SAB No. 108 is effective for fiscal years ending after November 15, 2006. The Company does not anticipate that SAB No. 108 will have a material effect on its consolidated financial statements.

In June 2006, the FASB issued Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* . This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, and provides guidance on derecognition,

ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

classification, interest and penalties, accounting in interim periods, disclosure, and transition. This Interpretation is effective for fiscal years beginning after December 15, 2006. The Company is currently assessing the impact of the Interpretation on its consolidated financial statements.

2. Acquisitions

Alphatec Spine, Inc.

On March 18, 2005, the Successor acquired all of the outstanding capital stock of Alphatec Spine. The acquisition was funded out of the net proceeds from the Company s initial capitalization in March 2005. The results of operations of Alphatec Spine have been included in the consolidated financial statements of the Successor from the date of acquisition. The total cost of the acquisition was as follows (in thousands):

Cash paid for common stock and stock options	$ 70,000
Debt assumed as a result of acquisition	5,458
Direct costs	1,046
Total purchase price	$ 76,504

The purchase price allocation is shown below (in thousands):

Cash and cash equivalents	$ 1,056
Accounts receivable	4,243
Inventories	4,669
Prepaid expenses and other current assets	483
Income taxes receivable	53
Property and equipment, net	3,607
Other assets	100
Accounts payable	(1,667)
Accrued and other expenses	(4,530)
Deferred income taxes	(3,075)
Net tangible assets	4,939
Developed product technology	13,700
Supplier agreement	221
In-process research and development (IPR&D)	3,100
Goodwill	54,544
Total purchase price	$ 76,504

In connection with this transaction, the Company conducted a valuation of the acquired assets and assumed liabilities in order to allocate the purchase price in accordance with SFAS No. 141, *Business Combinations* . Unless otherwise noted below, the fair value of the acquired tangible assets, assumed liabilities and supplier agreement was equal to the Predecessor s carrying value on March 18, 2005, the date of acquisition. The Company allocated the excess purchase price over the fair value of acquired net tangible and intangible assets to goodwill. A strong scientific employee base having existing relationships with prominent orthopedic surgeons and operations in an attractive market niche were among the factors that contributed to a purchase price resulting in the recognition of goodwill. Goodwill recorded for the acquisition of Alphatec Spine is not deductible for income tax purposes.

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ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The developed product technology represented proprietary knowledge that was technologically feasible as of the valuation date, and included all fully functioning products at the date of the valuation. Specifically, developed product technology represented proprietary knowledge related to the following products of the Company: Zodiac Lumbar Fusion and Deformity System, Mirage Spinal Fixation System, ROC Lumbar Plating System, Deltaloc Reveal Anterior Cervical Plate, Solanas Posterior Cervical/Thoracic Fusion, and various cage and bone products. The amount allocated to the developed product technology was assigned based on the estimated net discounted cash flows (income approach) from the related product line on March 18, 2005, the date of acquisition. The developed product technology is being amortized over a useful life of five years.

In accordance with SFAS No. 2, *Accounting for Research and Development Costs* , as clarified by the Financial Accounting Standards Board (FASB) Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method, an Interpretation of FASB Statement No. 2,* the amounts allocated to in-process research and development (IPR&D) expense were determined through established valuation techniques and were expensed upon acquisition as it was determined that the underlying projects had not reached technological feasibility and had no alternative future uses.

The fair value of the IPR&D was determined using the income approach. Under the income approach, the expected future cash flows from each project under development were estimated and discounted to their net present values at an appropriate risk-adjusted rate of return. Significant factors considered in the calculation of the rate of return were the weighted-average cost of capital and return on assets, as well as the risks inherent in the development process, including the likelihood of achieving technological success and market acceptance. Each project was analyzed to determine technological innovations that were unique, the existence and reliance on core technology, the existence of any alternative future use or current technological feasibility, and the complexity, cost and time to complete the remaining development. Future cash flows for each project were estimated based on forecasted revenue and costs, taking into account product life cycles, and market penetration and growth rates.

The IPR&D expense includes only the fair value of IPR&D performed as of the respective acquisition dates. The fair value of developed technology was included in identifiable purchased intangible assets. The Company believes the amounts recorded as IPR&D expense, as well as developed technology, represented the fair values and approximated the amounts an independent party would pay for these projects at the time of the respective acquisition dates.

As a result of the required adjustment of acquired assets and liabilities to fair value at the date of purchase, using the income approach, the Company increased inventory by $1.1 million over the historical cost. The inventory adjustment resulted in Successor cost of revenues of $1.1 million over what would have been recorded by the Predecessor.

Pursuant to the acquisition agreement, the stockholders of the Predecessor put $3.0 million in escrow in order to fund potential indemnification claims for losses incurred by the Company. The Company subsequently filed a claim for indemnification of $4.5 million in claims we experienced primarily relating to obsolete inventory, certain tax liabilities and uncollectible accounts receivable. On March 3, 2007, the Company settled the claim and received $1.0 million, which will be applied as a reduction of goodwill. The remaining $2.2 million in the escrow fund was returned to the shareholders of Alphatec Manufacturing. Certain shareholders of Alphatec Manufacturing used the proceeds from the distribution to purchase an aggregate of $1.1 million of the Company s common stock in a private placement.

ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Cortek, Inc.

On September 9, 2005, Alphatec Spine acquired certain assets and assumed certain liabilities of Cortek, a manufacturer and distributor of precision milled allograft products, in order to broaden the Company s product portfolio. The acquisition was funded out of the net proceeds from the Company s initial capitalization in March 2005. The results of operations of Cortek have been included in the consolidated financial statements of the Successor from the date of acquisition. At December 31, 2005, the total cost of the acquisition was as follows (in thousands):

Cash consideration	$ 6,500
Debt assumed as a result of acquisition	550
Direct costs	802
Total purchase price	$ 7,852

The purchase price allocation is shown below (in thousands):

Accounts receivable	$ 1,608
Inventories	2,268
Prepaid expenses and other current assets	76
Property and equipment, net	266
Other assets	57
Accounts payable	(955)
Accrued expenses	(1,313)
Net tangible assets	2,007
Goodwill	5,845
Total purchase price	$ 7,852

In connection with this transaction, the Company conducted a valuation of the acquired assets and assumed liabilities in order to allocate the purchase price in accordance with SFAS No. 141. The Company has allocated the excess purchase price over the fair value of acquired net tangible assets to goodwill. The enhancement of the Company s existing portfolio of spine fusion products with a complementary offering of precision milled allograft products was the primary factor that contributed to a purchase price resulting in the recognition of goodwill. Goodwill recorded for this acquisition will be deducted on a straight-line basis for income tax purposes over 15 years.

As a result of the required adjustment of acquired assets and liabilities to fair value at the date of purchase, using the income approach, the Company increased inventory by $0.4 million over the historical cost. The increased inventory value was recorded as cost of revenues as the related products were sold. As of December 31, 2006 and 2005, respectively, $0 and $0.2 million of this amount remained in ending inventory.

During the fourth quarter of 2005, the Company revised the purchase price allocation and reduced inventory by $0.9 million to conform Cortek s accounting for inventory to Alphatec s accounting for inventory.

During the year ended December 31, 2006, the preliminary valuation of certain assets and liabilities was adjusted by $0.4 million, resulting in a decrease of goodwill of the same amount.

Ishibe Medical Co, Ltd.

On November 1, 2005, Alphatec Pacific acquired all of the outstanding capital stock of Ishibe Medical Co, Ltd., a medical devices distributor headquartered in Sapporo, Japan. The direct cost of the acquisition was less than $0.3 million. The acquisition resulted in an increase to intangibles of approximately $1.1 million for distribution rights which are being amortized over three years. The results of operations have been included in the consolidated financial statements from the date of acquisition.

ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Pro Forma Statement of Operations

The following unaudited pro forma financial information reflects the consolidated results of operations as if the acquisition of Alphatec Spine and Cortek had occurred at the beginning of the period presented. The unaudited pro forma financial data is presented and is not necessarily indicative of the Company s results of operations that might have occurred had the transactions been completed at the beginning of the period presented, and do not purport to represent what the Company s consolidated results of operations might be for any future period.

(in thousands, except net loss per share)	Year Ended December 31, 2005
Revenues	$ 48,631
Net loss	(15,282)
Accretion to redemption value of redeemable convertible preferred, Rolling common and Series C common stock	(7,601)
Net loss available to common stockholders	$ (22,883)
Net loss per share basic and diluted	$ (1.26)
Weighted average shares outstanding basic and diluted	18,201

The pro forma results for 2005 include nonrecurring charges for the write-off of IPR&D of $3.1 million and the step up in the basis of the inventory of $1.1 million directly related to the acquisitions as if they had occurred at the beginning of the period presented.

Buyback of Distribution Rights

On August 11, 2005, the Company paid $3.1 million to repurchase its distribution rights in Japan. The transaction was entirely financed by Alphatec Pacific s current Chairman, President and Chief Executive Officer in return for the issuance of a note payable that was to be repaid in 18 equal monthly installments of $0.2 million (18.46% effective interest rate to scheduled maturity), beginning December 1, 2005. As additional compensation for making the loan to the Company, the Company granted Alphatec Pacific s Chairman, President and Chief Executive Officer a 20% interest in Alphatec Pacific, which had an estimated value of $0.6 million. This amount was recorded as debt issuance cost in the accompanying balance sheet. The note, plus accrued interest, totaling $3.0 million, was paid in full from the initial public offering proceeds in June 2006.

3. Balance Sheet Details

Accounts Receivable

Accounts receivable consist of the following (in thousands):

	December 31, 2006	December 31, 2005
Accounts receivable	$ 11,203	$ 10,145
Allowance for doubtful accounts	(620)	(784)
Total receivables, net	$ 10,583	$ 9,361

ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Inventories

Inventories consist of the following (in thousands):

	December 31, 2006			December 31, 2005		
	Gross	Excess and Obsolete	Net	Gross	Excess and Obsolete	Net
Raw materials	$ 1,725	$ (371)	$ 1,354	$ 1,482	$ (536)	$ 946
Work in-process	406		406	682		682
Finished goods	21,637	(9,943)	11,694	15,413	(8,583)	6,830
Total inventories, net	$ 23,768	$ (10,314)	$ 13,454	$ 17,577	$ (9,119)	$ 8,458

Property and Equipment

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

	Useful lives (in years)	December 31, 2006	December 31, 2005
Machinery and equipment	7	$ 5,905	$ 4,314
Surgical instruments	2 3	6,673	1,702
Computer equipment	5	1,316	497
Office furniture and equipment	5	2,464	1,293
Leasehold improvements	various	1,779	442
		18,137	8,248
Less accumulated depreciation and amortization		(5,554)	(1,042)
		$ 12,583	$ 7,206

The Company has assets under capital leases of $3.0 million and $2.9 million at December 31, 2006 and 2005, respectively. Accumulated depreciation on these assets totaled $1.1 million and $0.5 million at December 31, 2006 and 2005, respectively.

Acquired Intangibles

Acquired intangibles consist of the following (in thousands):

	(in years)	December 31, 2006	December 31, 2005
Developed product technology	5	$ 13,700	$ 13,700
Distribution rights	3	1,930	2,038
Supply agreement	10	225	225
		15,855	15,963

Less accumulated amortization		(5,670)		(2,319)
Total	$	10,185	$	13,644

ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Aggregate amortization expense for the year ended December 31, 2006 and the period from March 18, 2005 to December 31, 2005 was $3.4 million and $2.3 million, respectively. The Company had no significant amortization expense for the period from January 1, 2005 to March 17, 2005 and the year ended December 31, 2004.

The future expected amortization expense related to intangible assets as of December 31, 2006 is as follows (in thousands):

Year ending December 31,	
2007	$ 3,547
2008	3,069
2009	2,762
2010	708
2011	22
Thereafter	77
Total	$ 10,185

Accrued Expenses

Accrued expenses consist of the following (in thousands):

	December 31,	
	2006	**2005**
Current portion of severance payable	$ 3,159	$ 987
Commissions	2,111	1,028
Royalties	813	869
Payroll and related	1,305	1,716
Legal	913	1,496
Reserve for litigation costs	150	640
Other	1,918	2,096
	$ 10,369	$ 8,832

Included in the current portion of the severance payable balance at December 31, 2006 and 2005 is $0.6 million, which is the result of the termination of two employees who had employment agreements with the Predecessor. The employees were terminated by the Successor in 2005 and will be paid out in periodic installments through March 2008. Also, included in the current portion of the severance payable balance at December 31, 2006 is $2.6 million which is the result of the termination of several employees during 2006. The long-term portion of $0.7 million and $0.7 million, at December 31, 2006 and 2005, respectively, of severance payable to these employees is included in other long-term liabilities in the accompanying balance sheets.

4. Related Party Transactions

Predecessor Transactions

During 2003, the Predecessor loaned seven employees $0.3 million to purchase an aggregate of 295,000 shares of common stock from the Predecessor s majority stockholder. The repayment of the loans was due to the Predecessor in weekly installments over four years, bearing interest at 6%. If the employee ceased to be employed, the unpaid shares were returnable to the Predecessor.

ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The loans were secured by the underlying common stock and therefore the notes were considered to be non-recourse and the common stock underlying the notes was accounted for as variable. In accordance with SAB No. 79, transactions entered into by majority stockholders are accounted for as if transacted by the company. Since the shares essentially vested as they were paid for, expense was recorded on the date shares were paid for based on the difference between the purchase price and the fair value. Two of the employees were terminated during 2003 resulting in 28,864 shares reverting to the Predecessor at a cost of $0.03 million. Three of these employees were terminated during 2004 resulting in 178,192 shares of common stock reverting to the Predecessor at a cost of $0.2 million. One of the employees was terminated during the period from January 1, 2005 to March 17, 2005, resulting in 9,939 shares of common stock reverting to the Predecessor at an insignificant cost. The amount of the expense recorded for the period from January 1, 2005 to March 17, 2005 and the year ended December 31, 2004 was $0.2 million and $0.1 million, respectively.

During the period from January 1, 2005 to March 17, 2005, the Predecessor s majority stockholder and Chief Executive Officer sold 160,000 shares of common stock to certain employees at $1.50 per share which was subsequently determined to be less than the reassessed fair value of $6.70 at the date of the transaction. Accordingly, the Company recorded a stock-based compensation charge of $0.8 million in the accompanying statement of operations.

A stockholder and employee of both the Predecessor and the Successor was paid $2.1 million directly by the Predecessor s stockholders for financial advisory services provided in conjunction with the acquisition of the Predecessor.

Successor Transactions

During the year ended December 31, 2006, the Company employed the family member of a director and executive officer described below. The following family member under the Company s employ is an adult and did not live with the related director or executive officer. Each family member is compensated according to standard Company practices, including participation in the Company s benefit plans generally made available to employees of similar responsibility level. None of the Company s directors or executive officers believes that they have a direct or indirect material interest in the employment relationships of the listed family members. Options described below were granted under the Stock Plan and have a grant price equal to the fair market value on the date of grant. Such options vest in five equal annual installments over five years. Vesting is contingent upon continued service with the Company, although there is immediate vesting upon a change of control of the Company. Options granted under the Stock Plan have a maximum term of no more than 10 years.

Jonathan Hiscock is the son of Ronald G. Hiscock, a Director of the Company through March 28, 2007 and the Company s President and CEO through December 14, 2006. From September 2005 through December 15, 2006 Jonathan Hiscock served as a sales representative for the Company. Jonathan Hiscock earned $74,838 and $15,690 in salary, commissions and bonus during the years ended December 31, 2006 and 2005, respectively. On October 7, 2005 Jonathan Hiscock received a stock option grant for 1,160 shares of the Company s common stock at an exercise price of $0.002 per share.

On October 13, 2006 the Company entered into a Consulting Agreement with one of its directors, Dr. Stephen H. Hochschuler (the Consulting Agreement). Pursuant to the terms of the Consulting Agreement, the Company agreed to appoint Dr. Hochschuler to its Board of Directors until the next annual meeting of the Company s stockholders or his successor is duly appointed and qualified. Dr. Hochschuler s appointment was effective October 25, 2006. Pursuant to the Consulting Agreement Dr. Hochschuler is

ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

required to provide advisory services to the Company related to the spinal implant industry and the Company s research and development strategies. The agreement has a three-year term. In return for such advisory services, the Company is obligated to pay Dr. Hochschuler cash and equity compensation.

In June 2006, the Company paid HealthpointCapital, LLC an advisory fee of $1.0 million for services provided to the Company in connection with the completion of the Company s initial public offering pursuant to an oral arrangement with HealthpointCapital, LLC. In September 2006, the Company paid HealthpointCapital, LLC an additional $0.1 million for out-of-pocket expenses related to the Company s initial public offering.

In connection with the Successor s repurchase of certain distribution rights in Japan, the Company borrowed $3.1 million from Alphatec Pacific s Chairman, President and Chief Executive Officer in exchange for a note payable which bears an effective interest rate to scheduled maturity of 18.46% and a 20% ownership interest in Alphatec Pacific. For the year ended December 31, 2006 and the period from March 18, 2005 to December 31, 2005, the Company recorded interest expense totaling approximately $0.3 million and $0.2 million, respectively, under this note. The note, plus accrued interest, totaling $3.0 million, was paid in full from the initial public offering proceeds in June 2006.

In March 2005, the Company paid an advisory fee of $1.1 million to HealthpointCapital Advisors, LLC, a registered broker dealer that is an affiliate of the Company s principal stockholder, HealthpointCapital Partners, L.P. (HealthpointCapital) related to the financing of the acquisition of the Predecessor during the period ended December 31, 2005. In addition, the Company paid a finders fee to HealthpointCapital of $0.5 million in October 2005. The Company incurred costs of $0.5 million and $0.6 million, to Foster Management Company (an entity owned by the Company s Chairman and also a significant equity holder of HealthpointCapital, LLC, an affiliate of HealthpointCapital) for travel expenses, including the use of Foster Management Company s airplane for the year ended December 31, 2006 and the period from March 18, 2005 to December 31, 2005, respectively.

5. Supply Agreements

In July 2006, Alphatec Spine entered into a 30-month agreement to sell the product of a third party under Alphatec Spine s private label. The total minimum purchase commitment over the life of the contract is $8.0 million.

In March 2006, Alphatec Spine entered into a four-year agreement to sell the product of a third party under the Company s private label. The total minimum purchase commitment over the life of the contract is $6.0 million. As a result in the change in control of the supplier, our distribution rights will no longer be exclusive after June 30, 2007. In March 2007, we have made the decision to terminate this agreement and seek alternative suppliers of the product.

In February 2006, Alphatec Spine entered into a three-year non-exclusive license agreement to sell the product of a third party under the Company s private label. The total minimum purchase commitment over the life of the contract is $1.9 million.

In October 2004, the Predecessor entered into a ten-year agreement with one of its principal suppliers. This agreement fixes the price of materials with the supplier for the first 18 months and limits the annual price increase to eight percent for the remainder of the term of the agreement and requires three payments totaling $225,000. The Predecessor made a $75,000 payment in November 2004 and the Company made $75,000 payments in September 2005 and September 2006. The $225,000 was recorded as an intangible asset in the accompanying balance sheet.

ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

6. Debt

During the second quarter of 2006, Alphatec Spine entered into term loans with General Electric Capital Corporation (GECC), for approximately $2.7 million in order to finance certain previously purchased plant and office equipment. The loan terms are three years, bear interest from 11.23% to 11.42%, are secured by certain assets of Alphatec Spine, may not be prepaid without the consent of GECC and are guaranteed by Alphatec Holdings. Under the terms of these loans, Alphatec Spine is required to make 36 equal monthly principal and interest payments of $0.1 million and is subject to certain covenants, which include, among other things, prohibiting a net loss (as defined in the credit agreement by and between Alphatec Spine and Bank of the West) in any two consecutive quarters, requiring a specified ratio of debt to cash flow and a specified ratio of debt to tangible net worth, requiring certain levels of profitability and restricting certain mergers and acquisitions without prior approval from GECC. If Alphatec Spine fails to satisfy these covenants and fails to cure any breach of these covenants within a specified number of days after receipt of notice, or fails to pay interest or principal under the loan when due, GECC could accelerate the entire amount borrowed, which would also trigger a default under Alphatec Spine s credit facility from Bank of the West. Similarly, the GECC loan has cross default provisions relating to defaults under any material obligation of Alphatec Spine for other debt, deferred purchase price payments for property and lease payments. As of December 31, 2006, the Company is currently in compliance with the covenants under the GECC loan and has obtained an oral waiver of the cross default of the GECC loan provisions relating to defaults under the Company s Bank of the West line of credit. Alphatec Spine obtained a waiver from Bank of the West in order to obtain the GECC loan.

During the fourth quarter of 2006, Alphatec Spine entered into an additional term loan with GECC for approximately $1.0 million in order to finance certain previously purchased machinery and office equipment. The loan is for a term of three years, bearing interest of 10.55% and Alphatec Spine is required to make 36 equal monthly principal and interest payments of $0.03 million. The term loan has similar requirements as the term loan executed in the second quarter of 2006.

On January 24, 2006, Alphatec Spine entered into a two-year term, $10.0 million revolving line of credit with Bank of the West to provide the working capital necessary to support the expansion of the Company s distribution channels. Borrowing under the financing arrangement will bear interest at the bank s prime rate or LIBOR plus 2.25%, with interest payable monthly. Availability under the revolving line of credit is subject to a borrowing base equal to 80% of eligible accounts receivable and 20% to 50% of eligible inventory, subject to certain limitations. Under the terms of this credit facility, Alphatec Spine is required to make monthly interest payments and is subject to certain covenants, which include among other things, prohibiting a net loss (as defined in the credit agreement) for fiscal 2005 in excess of $2.0 million, requiring a specified ratio of debt to cash flow and a specified ratio of debt to tangible net worth plus subordinated debt, requiring certain levels of profitability (as defined in the credit agreement) and restricting certain mergers and acquisitions without prior approval of the bank. In addition, this credit facility prohibits Alphatec Spine from declaring or paying cash dividends. The financing is collateralized by substantially all of the assets and capital stock of Alphatec Spine and is guaranteed by the Company. In the third amendment to the credit agreement dated as of July 27, 2006, the revolving line of credit was increased by $2 million to $12 million. As of December 31, 2006 there were no outstanding borrowings under this line of credit. As of September 30 and December 31, 2006, the Company was not in compliance with several of the covenants under this credit facility. In November 2006 and March 2007, Alphatec Spine obtained a waiver for the covenant breach and entered into an amendment to the credit facility, pursuant to which the interest rate of the facility is increased from the bank s prime rate or LIBOR plus 2.25% to the bank s prime rate plus 0.50% or LIBOR plus 3.25%. The March 2007 bank amendment deleted the quarterly and annual net profit financial condition, modified the net loss financial condition and modified the definition of the borrowing base covenants.

ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Alphatec Pacific has a $2.6 million credit facility with a Japanese bank, under which $2.6 million and $1.4 million were outstanding at December 31, 2006 and December 31, 2005, respectively. Under the terms of the line of credit, borrowings are due nine months from the date of borrowing and bear interest at 3.5%. Under the terms of the credit facility Alphatec Pacific is required to make monthly interest payments. The credit facility is secured by a standby letter of credit issued on behalf of the Company through Bank of the West which expires on October 31, 2007.

In July 2005, Alphatec Spine, Inc. entered into a $4.0 million credit facility with a bank. The facility is for a term of one year, bears interest at the bank s prime rate and is secured by substantially all of the Alphatec Spine, Inc. s assets. Under the terms of this credit line, Alphatec Spine is required to make monthly interest payments and is subject to certain covenants. At December 31, 2005, borrowings outstanding under this line totaled $2.5 million. This credit facility was replaced with a new borrowing facility in January 2006.

Long-term debt and note payable to related party consists of the following (in thousands):

	December 31, 2006	December 31, 2005
Notes payable to Japanese Banks, bearing interest at rates ranging from 2.55% to 4.15%, maturity dates through June, 2008, collateralized by substantially all assets of Alphatec Pacific	$ 286	$ 1,021
Note payable to related party, bearing interest at an effective rate to scheduled maturity of 18.46%, 18 equal monthly principal and interest payments of $197,962 from December 2005 through May 2007		2,481
Capital leases, bearing interest at rates ranging from 0.0% to 16.44%, generally due in monthly principal and interest installments, maturity dates through March 2010, collateralized by the related equipment (Note 7)	1,363	1,987
Note payable related to equipment purchases, bearing interest at rates ranging from 10.55% to 11.42%, generally due in monthly principle and interest installments, maturity dates through December 2009, collateralized by the related equipment (Note 7)	3,363	
Other loans, bearing interest rates ranging 5.59% to 7.84%, generally due in monthly principle and interest installments, maturity dates through August 2007 (Note 7)	159	
	5,171	5,489
Less: current portion related party		(1,700)
Less: current portion external party	(2,060)	(1,280)
	$ 3,111	$ 2,509

Principal payments on long-term debt (excluding capital leases) are as follows as of December 31, 2006 (in thousands):

Year ending December 31,	
2007	$ 1,548
2008	1,351
2009	909
Total	$ 3,808

ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 2010. Future minimum annual lease payments under such leases as of December 31, 2006 are as follows (in thousands):

Year Ending December 31,	Operating	Capital
2007	$ 1,792	$ 625
2008	790	519
2009	293	340
2010	207	13
2011	140	
	$ 3,222	1,497
Less: amount representing interest		(134)
Present value of minimum lease payments		1,363
Current portion of capital leases		(545)
Capital leases, less current portion		$ 818

Rent expense under operating leases for the year ended December 31, 2006, the period from March 18, 2005 to December 31, 2005, the period from January 1, 2005 to March 17, 2005, and the year ended December 31, 2004 was $1.2 million, $1.0 million, $0 and $0.3 million, respectively.

Litigation

The Company is involved from time to time in litigation or claims arising in the ordinary course of its business. While the ultimate liability, if any, arising from these claims cannot be predicted with certainty, the Company believes that the resolution of these matters will not likely have a material adverse effect on the Company s consolidated financial statements.

The Company accrues for potential litigation settlements based on either a settlement offer from the plaintiff or the agreed upon settlement, or in some cases, an estimation, based upon what our management believes is the low-range of potential liability. The amounts accrued at December 31, 2006 and 2005 are not significant.

On June 26, 2006, Biedermann Motech GmbH and Depuy Spine, Inc. filed suit for patent infringement against a number of companies including Alphatec Spine. The complaint, filed in United States District Court, District of Massachusetts, relates to U.S. Patent No. 5,207,678. Biedermann Motech owns the patent and Depuy is the exclusive licensee of the patent. In the complaint, the plaintiffs sought monetary damages and injunctive relief related to such alleged infringement. On July 21, 2006, Biedermann Motech and Depuy filed a motion of preliminary injunction seeking to enjoin the Company from further sales and manufacture of its Zodiac and Solanas products pending the outcome of litigation. The Company responded to this complaint on July 31, 2006 and filed counterclaims against Depuy related to actions taken by Depuy s sales force related to this litigation. In its counterclaim, the Company seeks to have Depuy s sales force cease and desist its actions related to this litigation and to invalidate the 678 patent. On October 26, 2006 the plaintiff s motion for a preliminary injunction was denied. The Company does not believe that any of its products infringe on this patent and intends to vigorously defend itself against this complaint. The ultimate impact on the financial statements cannot be determined at this time.

ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

On April 12, 2006, the Company and HealthpointCapital, its majority stockholder, and its affiliate, HealthpointCapital, LLC, were served with a complaint by Drs. Darryl Brodke, Alan Hilibrand, Richard Ozuna and Jeffrey Wang (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, the Company was required to pay the claimant surgeons quarterly royalties in an aggregate amount of 6% of the net sales of polyaxial screws, which the claimant surgeons allege were developed with their assistance prior to the cessation of such development activities in March 2002. The Company first began to sell polyaxial screws in 2003 and has continued to sell them through the date of this report. 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 Company does not believe that any of the claimant surgeons are entitled to any royalty amounts and intends to vigorously defend itself against this complaint; however the Company cannot predict the outcome to this matter or the impact on the financial statements, if any.

Litigation Settlements

On February 2, 2006, Alphatec Spine filed a joint complaint with Alphatec Spine s former President and CEO, Ronald G. Hiscock, in California State Superior Court against Benchmark Medical, Inc. and Benchmark Medical Holdings, Inc., in connection with Benchmark s failure to pay Mr. Hiscock certain amounts due to him pursuant to his severance agreement with Benchmark. In addition, the complaint sought a declaratory judgment affirming Alphatec Spine s ability to recruit and hire former Benchmark employees. In March 2006, Benchmark filed a complaint against Mr. Hiscock and the Company s Senior Vice President and Chief Administrative Officer, Vicky Romanoski, in Pennsylvania State court in which Benchmark claimed that each of them violated the terms of their respective severance agreements with Benchmark and sought to have the matter litigated in Pennsylvania rather than California. On June 21, 2006, the Company executed a settlement agreement with Benchmark that relieves all parties of all obligations related to prior severance and promissory note agreements between Benchmark and Mr. Hiscock and Ms. Romanoski. The agreement also settles litigation brought by Alphatec and Benchmark against one another related to these matters.

On or about November 22, 2005, the Company, among other entities, was served with a complaint by Abbott Spine, Inc. in the United States District Court for the District of Arizona. The complaint alleged that Alphatec Spine tortuously interfered with a contract that Abbott had with one of its independent sales agents and tortuously interfered with Abbott s customer relationships in Arizona. In the complaint, Abbott sought monetary damages and to have Alphatec cease and desist the alleged interference. On August 4, 2006, the matter was settled pursuant to a settlement agreement. The settlement agreement ends the litigation brought by Abbott against all parties related to these matters.

Put Right

On August 11, 2005, the Company entered into a Stock Purchase Agreement with Alphatec Pacific s Chairman, President and Chief Executive Officer in connection with the financing to repurchase certain distribution rights in Japan. The Stock Purchase Agreement provided the related party with the option to purchase 40 shares of the then outstanding 200 shares of Alphatec Pacific for $1.00, which was exercised on August 11, 2005. Under the terms of the Stock Purchase Agreement, Alphatec Pacific s Chairman, President and Chief Executive Officer has the right to require the Company to repurchase the shares beginning one year from the

ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

completion of an initial public offering by the Company. In addition, the Company has an obligation to repurchase those shares upon certain changes of control of Alphatec Holdings, Alphatec Spine or Alphatec Pacific or upon termination of the employment of the stockholder. The repurchase price is equal to the sum of 60% of annualized revenue from the sale of spine products and 20% of annualized revenues from the sales of other orthopedic device revenues by Alphatec Pacific, except in the event of a change of control of Alphatec Pacific, where it will be equal to a proportionate share of the price paid for Alphatec Pacific.

The fair value of the 40 shares was established on August 11, 2005 in the amount of $0.6 million and was recorded as minority interest and as debt issuance cost for the note payable to Alphatec Pacific s Chairman, President and Chief Executive Officer. In June 2006, the Company paid off the note financing its repurchase of the distribution rights in Japan with proceeds from its initial public offering. The remaining balance of debt issuance costs was expensed at that time. Interest expense of $0.5 million and $0.1 million was recorded for amortization of debt issuance cost for the year ended December 31, 2006 and the period from March 18, 2005 to December 31, 2005, respectively.

Subsequent to the original valuation on August 11, 2005, the value of the put right is being accounted for under SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity* . In accordance with SFAS No. 150, the put right is classified as a liability and is represented by the minority interest in the accompanying consolidated balance sheets at December 31, 2006 and 2005. The value of the put right at any reporting date is remeasured at the amount of cash that would be paid under the terms of the agreement as if the settlement occurred on that reporting date and recognizes the amount of the change from the previous reporting date as interest cost. In addition to the interest cost recorded for the change in the value of the put right, the Company consolidates 100% of Alphatec Pacific s operations. Interest expense of $0.8 million and $1.3 million, respectively, was recorded for the year ended December 31, 2006 and the period from August 12, 2005 to December 31, 2005.

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.

Agreements with Scient x, S.A.

On September 27, 2006, we entered into two Stock Purchase Agreements, one with Olivier Carli and one with HealthpointCapital in an attempt to obtain a controlling interest in Scient x, a French medical device manufacturer. If consummated the transaction contemplated by both agreements, we would have acquired through direct and indirect holdings, 74.1% of the outstanding stock of Scient x.

On January 23, 2007, Alphatec Spine has signed three license agreements with Scient x S.A., a French medical device manufacturer, pursuant to which Alphatec Spine will have rights under Scient x S.A. s proprietary technology related to (i) the Scient x Isobar posterior dynamic stabilization rod (ii) the Scient x Stella cervical plate, and (iii) the Scient x Antelys plate-cage to produce, market, sell and distribute (i) a posterior dynamic stabilization rod, (ii) a thin profile cervical plate; and (iii) a plate-cage in the United States. The agreement provides that Alphatec Spine will make an upfront payment of $2.6 million, pay a royalty on sales (with minimum royalties for a period of three years), and commit to purchase a minimum amount of Isobar inventory, at cost, for a period of two years.

ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

On January 23, 2007, in connection with Alphatec Spine s entry into the license agreement described above, the Company entered into a termination and release agreements between us, HealthpointCapital and Olivier Carli that cancels the proposed merger agreements. The company incurred $2.0 million of expenses related to the failed acquisition.

Severance Obligations

In the fourth quarter of 2006, the Company had a reorganization of its executive team that involved the departure of the President and Chief Executive Officer, Senior Vice President and Chief Administrative Officer, Chief Financial Officer, Vice President Sales, Vice President Business Development and Vice President Marketing. In accordance with their employment agreements, we recorded $6.9 million in severance expense, which consisted of $3.7 million in stock compensation expense as a result of adoption of 123(R) and $3.2 million in severance payments. As of the end of December 31, 2006, $0.1 million in severance payments had been paid.

8. Predecessor Stockholders Equity

Stock Options

The Predecessor had an incentive stock option and nonqualified stock option plan (the Predecessor Plan). The Predecessor Plan was revised in 2002 and provided for the granting of options to selected employees, directors, and consultants of the Predecessor to purchase up to 2,000,000 shares of the Predecessor s common stock at prices not less than the fair market value of the stock at the date of grant. The option expiration dates were determined at the date of grant, were not to exceed 10 years, and the options generally became exercisable over a three-year period.

Stock option activity for the years ended December 31, 2003 and 2004 and the period ended March 17, 2005 was as follows (in thousands):

	Number of options	Weighted average exercise price
Outstanding at December 31, 2003	975	$ 1.92
Granted	674	$ 1.50
Cancelled	(293)	$ 1.98
Exercised	(10)	$ 1.00
Outstanding at December 31, 2004	1,346	$ 1.70
Granted		
Cancelled		
Exercised		
Outstanding at March 17, 2005	1,346	$ 1.70

On March 17, 2005, when the Company acquired the Predecessor and the change in control provisions of the outstanding stock options were triggered, the outstanding unvested stock options became fully vested.

ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

9. Successor Redeemable Convertible Preferred and Rolling Common Stock and Stockholders Equity

Initial Capitalization

In March 2005, the Company was capitalized through the sale of preferred stock units, consisting of shares of preferred stock and common stock, and the sale of Rolling common stock. The immediate redemption value of the preferred shares was equal to the unit price of the preferred stock unit and accordingly, none of the proceeds were allocated to the shares of common stock. During the fourth quarter of 2005 and the first quarter of 2006, the Company sold 138,345 shares of Series C common stock at $33.33 per share, resulting in $4.6 million of net proceeds. The tables below summarize the number of shares of preferred stock and common stock comprising each unit, as well as the number of shares of Rolling common and Series C common stock, and the gross proceeds received by the Company for, and the aggregate carrying value of, the redeemable convertible preferred stock, Rolling common and Series C common stock at December 31, 2005:

	December 31, 2005			
Unit	**Shares authorized**	**Preferred shares**	**Common shares**	**Net proceeds**
Series A	1,800	1,539	2,420	$ 15,390
Series A-1	3,942	2,903	4,564	29,035
Series B	4,687	4,000	11,633	40,000
Rolling common	200	200		4,481
Series C common	300	131		4,359
	10,929	8,773	18,617	$ 93,265
Gross issuance costs				(1,518)
Accretion to redemption value through and as of December 31, 2005				5,682
Beneficial conversion feature of Series C common stock				1,919
Carrying value at December 31, 2005				$ 99,348

Initial Public Offering, Redemption of Securities and New Redeemable Preferred Stock

On June 7, 2006, the Company completed an initial public offering (IPO) whereby it sold 9.3 million shares of common stock at $9.00 per share and received net proceeds of $70.2 million (after underwriting discounts and commissions and offering costs). Simultaneously with the closing of the IPO, the existing classes of common stock were also converted into a single class of common stock and all of the Company s redeemable convertible preferred stock was redeemed for a combination of $35.2 million of cash, 3.3 million shares of new redeemable preferred stock recorded at estimated fair value of $23.7 million and 3.6 million of new shares of common stock valued at $44.2 million.

There were 20 million shares authorized as of December 31, 2006 of the new preferred stock, which is not convertible into common stock but is redeemable at $9.00 per share, the Company s initial public offering price, (i) upon the Company s liquidation, dissolution or winding up, or the occurrence of certain mergers, consolidations or sales of all or substantially all of the Company s assets, before any payment to the holders of the Company s common stock, or (ii) at the Company s option at any time. Holders of redeemable preferred stock are generally not entitled to vote on matters submitted to the stockholders, except with respect to certain matters that will affect them adversely as class, and are not entitled to receive dividends. The carrying value of the new redeemable preferred stock is $7.11 per share at December 31, 2006.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Under SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity,* the redeemable preferred stock is required to be shown in the Company s financial statements separate from stockholders equity and any adjustments to its carrying value up to its redemption value of $9 per share will be reported as a dividend.

Beneficial Conversion Feature on Sale of Series C common stock

The Series C common stock was sold at a price per share below the anticipated IPO price. Accordingly, pursuant to EITF Issue No. 98-5, *Accounting for Convertible Securities with Beneficial Conversion Features* , the Company recorded a deemed dividend on the Series C common stock of $1.9 million at December 31, 2005 and an additional $0.1 million during the twelve months ended December 31, 2006, which is equal to the number of shares of Series C common stock sold multiplied by the difference between the estimated fair value of the underlying common stock and the Series C common stock conversion price per share. The deemed dividend increased the net loss applicable to common stockholders in the calculation of basic and diluted net loss per common share and was reported as an increase to the Series C common stock and a credit to additional paid-in capital.

Series A Common, Series A-1 Common, Series B Common and Common Stock

The authorized, issued and outstanding shares of common stock by series are as follows (in thousands)

	December 31, 2006		December 31, 2005	
	Shares authorized	Shares issued and outstanding	Shares authorized	Shares issued and outstanding
Series A common			2,419	2,420
Series A-1 common			7,064	6,549
Series B common			11,634	11,633
Old common			49,731	
New common	200,000	34,774		
	200,000	34,774	70,848	20,602

ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In connection with the issuance of options to purchase 122,297 shares of Series A-1 common stock and the sale of 1,937,439 shares of Series A-1 common stock to employees during the period from March 18, 2005 to December 31, 2005, the Company recorded total deferred employee stock-based compensation within stockholders equity of $20.5 million, which represents the difference between the estimated fair value of the common stock and the option exercise price or stock issuance price at the date of issuance. The deferred employee stock-based compensation is amortized over the vesting period of the applicable equity instrument on a straight-line basis.

The expected future amortization expense for deferred employee stock-based compensation is as follows as of December 31, 2005 (in thousands):

Year ending December 31,	
2006	$ 3,916
2007	3,916
2008	3,926
2009	3,916
2010	2,622
	$ 18,296

Upon the adoption of SFAS No. 123(R) on January 1, 2006, the deferred compensation balance of $18.3 million was reclassified against additional paid-in capital and retained earnings.

The holders of new common stock are entitled to one vote for each share held on all matters except with respect to amendments to the Restated Certificate of Incorporation that relate solely to the terms of the redeemable preferred stock. Dividends may be declared and paid from funds lawfully available and subject to the rights and preferences of any shares of redeemable preferred stock. The Company does not plan on declaring any dividends in the foreseeable future.

Stockholder Loan

In March 2005, the Company loaned the spouse of an employee stockholder $0.2 million for the purchase of Rolling common stock. Interest on the outstanding principal balance accrues at the federal funds rate with both principal and interest due at the earlier of: (i) the first anniversary of the note or (ii) an initial public offering of the shares of capital stock of the Company. The note is secured by certain funds held in escrow. As of December 31, 2005, the balance of the note was $0.1 million. The loan was paid in full in February 2006.

Stock Options

In 2005, the Company adopted its 2005 Employee, Director, and Consultant Stock Plan (2005 Plan). The 2005 Plan allows for the grant of options and restricted stock awards to employees, directors, and consultants of the Company. The 2005 Plan has 6,400,000 shares of common stock reserved for issuance. The Board of Directors determines the terms of the restricted stock and the term of each option, option price, number of shares for which each option is granted, whether restrictions will be imposed on the shares subject to options, and the rate at which each option is exercisable. Options granted under the 2005 Plan expire no later than 10 years from the date of grant (five years for incentive stock options granted to holders of more than 10% of the Company s voting stock). Options generally vest over a five-year period and may be immediately exercisable upon a change of control of the Company. The exercise price of incentive stock options may not be less than 100% of the fair value of the Company s common stock on the date of grant. The exercise price of any option granted to a 10% stockholder may be no less than 110% of the fair value of the Company s common stock on the date of grant. At December 31, 2005 and December 31, 2006, a total of 272,991 and 4 million shares, respectively, of common stock remained available for issuance under the 2005 Plan.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

A summary of the Company s stock option activity under the 2005 Plan and related information from March 18, 2005 through December 31, 2006 are as follows:

	Shares	Weighted average exercise price	Weighted average remaining contractual life (in years)	Aggregate intrinsic value as of December 31, 2006
	(In thousands, except per share data)			
Outstanding at March 18, 2005				
Granted	122	$ 0.89		
Exercised				
Forfeited	(6)	$		
Outstanding at December 31, 2005	116	$ 0.93	9.71	
Granted	961	$ 4.40		
Exercised	(1)			
Forfeited	(339)	$ 4.57		
Outstanding at December 31, 2006	737	$ 3.76	9.54	$ 468
Exercisable at December 31, 2006	17	$ 0.52	2.21	$ 57
Vested or expected to vest at December 31, 2006	501	$ 3.72	8.67	$ 341

The weighted-average fair value of options granted in the years ended December 31, 2006 and 2005 was $5.60 and $10.09 per share, respectively. The aggregate intrinsic value of options at December 31, 2006 is based on the company s closing stock price on December 29, 2006 of $3.73. Proceeds from the exercise of stock options during the year ended December 31, 2006 was immaterial.

The following table summarizes information about stock options outstanding and exercisable at December 31, 2006:

		December 31, 2006				
		Options outstanding			Options exercisable	
Range of exercise prices		Number outstanding	Weighted average remaining contractual life (in years)	Weighted average exercise price	Number exercisable	Weighted average exercise price
$0.001	$ 0.001	77	8.64	$ 0.001	15	$ 0.001
$3.210	$ 4.762	523	9.65	$ 3.634	2	$ 4.762
$4.763	$ 5.500	9	9.55	$ 5.500		$
$5.501	$ 5.890	52	9.72	$ 5.890		$
$5.891	$ 6.100	49	9.63	$ 6.100		$
$8.070	$ 8.070	27	9.47	$ 8.070		$

$0.001	$ 8.070	737	9.54	$ 3.759	17	$ 0.001

ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Restricted Stock Awards

The following table summarizes information about the restricted stock awards activity from March 18, 2005 through December 31, 2006:

	Shares	Weighted average grant date fair value	Weighted average remaining contractual life (in years)	Aggregate intrinsic value as of December 31, 2006
	(In thousands, except per share data)			
Outstanding at March 18, 2005		$		
Awarded	2,076	$ 10.37		
Released		$		
Forfeited	(91)	$ 9.95		
Outstanding at December 31, 2005	1,985	$ 10.47	2.56	$ 20,768
Awarded		$		
Released		$		
Forfeited	(322)	$ 9.98		
Outstanding at December 31, 2006	1,663	$ 10.57	2.07	$ 17,500

There were no restricted stock awards granted in the year ended December 31, 2006. The weighted-average fair value of awards granted in the year ended December 31, 2005 was $10.47 per share.

Common Stock Reserved for Future Issuance

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

	December 31, 2006	December 31, 2005
	(In thousands)	
Stock Options outstanding	737	117
Authorized for future grant under 2005 Plan	4,000	273
	4,737	390

The company recorded expense of $0.1 million and $0.04 million in 2006 and 2005, respectively, related to the vesting of stock options and awards granted to non-employees under consulting agreements, in accordance with EITF 96-18.

ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

10. Income Taxes

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

	Successor Year ended December 31, 2006	Successor March 18, 2005 to December 31, 2005	Predecessor January 1, 2005 to March 17, 2005	Predecessor Year Ended December 31, 2004
Current:				
Federal	$ (41)	$ 48	$	$
State				95
Foreign	28	2	2	1
	(13)	50	2	96
Deferred:				
Federal	155	(2,481)		
State	33	(594)		
Foreign	95	(14)		
	283	(3,089)		
	$ 270	$ (3,039)	$ 2	$ 96

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

	Successor Year ended December 31, 2006	Successor March 18, 2005 to December 31, 2005	Predecessor January 1, 2005 to March 17, 2005	Predecessor Year Ended December 31, 2004
Federal statutory rate	(35.0)%	(35.0)%	(34.0)%	34.0%
Adjustments for tax effects of:				
State taxes, net	(3.0)%	(2.4)%	(3.7)%	9.7%
In-process research and development	%	6.8%	%	%
Stock-based compensation	12.1%	2.9%	5.4%	5.2%
Foreign tax	1.2%	(1.1)%	1.1%	4.1%
Fair value change of put option	1.1%	2.9%	%	%
Other	2.6%	1.2%	0.9%	7.9%
Valuation allowance	22.0%	5.5%	30.4%	(45.0)%
	1.0%	(19.2)%	0.1%	15.9%

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Significant components of the deferred tax assets and liabilities are as follows (in thousands):

	December 31, 2006	December 31, 2005
Deferred Tax Assets:		
Allowances and reserves	$ 400	$ 350
Accrued expenses	1,876	857
Inventory reserves	2,764	1,779
Net operating loss carryforwards	5,140	3,254
Income tax credit carryforwards	41	36
	10,221	6,276
Valuation allowance	(6,498)	(880)
Total deferred tax assets, net of valuation allowance	3,723	5,396
Deferred Tax Liabilities:		
Property and equipment	56	357
Intangible assets	3,950	5,039
Total deferred tax liabilities	4,006	5,396
Net deferred tax liabilities	$ (283)	$

The realization of deferred tax assets may be dependent on the Company s ability to generate sufficient income in future years. As of December 31, 2006, a valuation allowance of $6.5 million has been established against the net deferred tax assets as realization is uncertain. Deferred tax liabilities associated with tax goodwill cannot be considered a source of taxable income to support the realization of deferred tax assets because the reversal of these deferred tax liabilities is considered indefinite.

At December 31, 2006, the Company had federal, state and foreign tax loss carry forwards of approximately $11.9 million, $12.9 million, and $0.7 million, respectively. If unused, the federal, state and foreign tax loss carry forwards begin to expire in 2023, 2010 and 2012, respectively.

The utilization of net operating loss carry forwards and tax credit carry forwards is dependent on the future profitability of the Company. Furthermore, the Internal Revenue Code imposes substantial restrictions on the utilization of net operating loss and tax credit carry forwards in the event of an ownership change of more than 50 percentage points during any three year period. Due to prior ownership changes as defined by IRC Section 382, a portion of the Company s net operating loss and tax credit carry forwards may be limited in their annual utilization.

Pretax earnings of a foreign subsidiary or affiliate are subject to U.S. taxation when effectively repatriated. U.S. income taxes and foreign withholding taxes were not provided on undistributed earnings of foreign subsidiaries. The Company intends to reinvest these earnings indefinitely in its foreign subsidiaries. It is not practical to determine the amount of undistributed earnings or income tax payable in the event the Company repatriated all undistributed foreign earnings. However, if these earnings were distributed to the U.S. in the form of dividends or otherwise, the Company would be subject to additional U.S. income taxes and foreign withholding taxes, offset by an adjustment for foreign tax credits.

The Company is subject to income taxes in the United States and various foreign jurisdictions. In the ordinary course of the Company s business there are calculations and transactions where the ultimate tax determination is uncertain. The Company believes that it has adequately provided for income tax issues not yet resolved with federal, state, and foreign tax authorities. If these amounts

ALPHATEC HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

provided prove to be more than what is necessary, the reversal of the reserves would result in tax benefits being recognized in the period in which the Company determines that provision for the liabilities is no longer necessary. If an ultimate tax assessment exceeds the Company s estimate of tax liabilities, an additional charge to expense will result.

11. Employee Retirement Plans

The Predecessor had a 401(k) Plan for the benefit of its employees. The 401(k) Plan covered all eligible employees. All employees who had a minimum of six months of service could elect to contribute to the 401(k) Plan up to 20% of their compensation to the annual maximum limit established by the IRS. The Predecessor did not make any contributions to the 401(k) Plan from inception to March 17, 2005. The Successor assumed the 401(k) Plan upon acquisition of the Predecessor and amended the 401(k) Plan on August 1, 2005 to reflect the following changes: (i) all eligible employees may participate in the plan immediately with no waiting period, (ii) the Successor may make discretionary matches to the 401(k) Plan of up to 4% of each individual s compensation, and (iii) Successor match amounts are immediately vested. The Successor made matching contributions to the 401(k) Plan of $0.6 million and $0.2 million, respectively, for the year ended December 31, 2006 and the period from March 18, 2005 to December 31, 2005.

12. Quarterly Financial Data (Unaudited)

The following financial information reflects all normal recurring adjustments, which are, in the opinion of management, necessary for a fair statement of the results of the interim periods. Summarized quarterly data for fiscal 2006 and 2005 are as follows (in thousands, except per share data):

	Year ended December 31, 2006			
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Selected quarterly financial data:				
Revenue	18,029	19,422	17,358	19,196
Gross profit	11,620	12,855	10,752	13,078
Total operating expenses	14,730	16,665	16,361	22,663
Net loss	(5,876)	(3,178)	(5,438)	(11,324)
Net loss available to common stockholders	(7,819)	(4,686)	(5,468)	(11,293)
Basic and diluted net loss per common share	$ (0.42)	$ (0.20)	$ (0.16)	$ (0.34)

	Year ended December 31, 2005				
	Successor	Predecessor			
	January 1 to March 17	March 18 to December 31	2nd Quarter	3rd Quarter	4th Quarter
Selected quarterly financial data:					
Revenue	$ 6,050	$ 851	8,320	11,527	15,578
Gross profit	4,368	532	4,515	6,543	8,646
Total operating expenses	5,444	3,879	6,330	10,995	12,999
Net loss	(1,189)	(3,495)	(1,277)	(3,489)	(4,604)
Net loss available to common stockholders	(1,189)	(3,726)	(2,986)	(5,316)	(8,438)
Basic and diluted net loss per common share	$ (0.15)	(1.55)	$ (0.17)	$ (0.29)	$ (0.45)

(1) Earnings (loss) per share are computed independently for each of the quarters presented. Therefore, the sum of the quarterly net earnings (loss) per share will not necessarily equal the total for the year.