

Alphatec Holdings, Inc.  
Form 10-Q  
October 30, 2014

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2014

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 000-52024

ALPHATEC HOLDINGS, INC.  
(Exact name of registrant as specified in its charter)

|  |                                      |
|--|--------------------------------------|
| Delaware   | 20-2463898                           |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| 5818 El Camino Real  |                                      |
| Carlsbad, CA 92008   |                                      |
| (Address of principal executive offices, including zip code)   |                                      |
| (760) 431-9286   |                                      |
| (Registrant's telephone number, including area code)           |                                      |

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

|                         |                          |                   |                                     |
|-------------------------|--------------------------|-------------------|-------------------------------------|
| Large accelerated filer | <input type="checkbox"/> | Accelerated filer | <input checked="" type="checkbox"/> |
|-------------------------|--------------------------|-------------------|-------------------------------------|

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Non-accelerated filer  (Do not check if a small reporting company) Smaller reporting company   
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) Yes  No  As of October 29, 2014, there were 98,193,372 shares of the registrant's common stock outstanding.

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ALPHATEC HOLDINGS, INC.  
 QUARTERLY REPORT ON FORM 10-Q  
 September 30, 2014  
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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

## ALPHATEC HOLDINGS, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

(In thousands, except for par value data)

|   | September 30,<br>2014 | December 31,<br>2013 |
|---|-----------------------|----------------------|
| Assets  |                       |                      |
| Current assets:   |                       |                      |
| Cash  | \$20,169              | \$21,345             |
| Restricted cash   | 2,001                 | —                    |
| Accounts receivable, net  | 40,053                | 41,395               |
| Inventories, net  | 41,986                | 41,939               |
| Prepaid expenses and other current assets   | 7,230                 | 7,694                |
| Deferred income tax assets  | 1,273                 | 1,372                |
| Total current assets  | 112,712               | 113,745              |
| Property and equipment, net   | 26,510                | 28,030               |
| Goodwill  | 175,089               | 183,004              |
| Intangibles, net  | 32,428                | 39,064               |
| Other assets  | 1,863                 | 1,787                |
| Total assets  | \$348,602             | \$365,630            |
| Liabilities and Stockholders' Equity  |                       |                      |
| Current liabilities:  |                       |                      |
| Accounts payable  | \$11,333              | \$10,790             |
| Accrued expenses  | 34,995                | 62,996               |
| Deferred revenue  | 1,142                 | 1,009                |
| Common stock warrant liabilities  | 10,660                | —                    |
| Current portion of long-term debt   | 8,042                 | 4,924                |
| Total current liabilities   | 66,172                | 79,719               |
| Long-term debt, less current portion  | 70,617                | 49,978               |
| Other long-term liabilities   | 32,965                | 38,784               |
| Deferred income tax liabilities   | 1,925                 | 1,870                |
| Redeemable preferred stock, \$0.0001 par value; 20,000 authorized at September 30, 2014 and December 31, 2013; 3,319 shares issued and outstanding at both September 30, 2014 and December 31, 2013         | 23,603                | 23,603               |
| Stockholders' equity:   |                       |                      |
| Common stock, \$0.0001 par value; 200,000 authorized at September 30, 2014 and December 31, 2013; 98,203 and 97,599 shares issued and outstanding at September 30, 2014 and December 31, 2013, respectively |                       | 10                   |
| Treasury stock, 19 shares   | (97                   | ) (97                |
| Additional paid-in capital  | 412,636               | 403,568              |
| Shareholder note receivable   | (5,000                | ) —                  |
| Accumulated other comprehensive (loss) income   | (5,938                | ) 3,877              |
| Accumulated deficit   | (248,291              | ) (235,682           |
| Total stockholders' equity  | 153,320               | 171,676              |
| Total liabilities and stockholders' equity  | \$348,602             | \$365,630            |

See accompanying notes to unaudited condensed consolidated financial statements.



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

|   | Three Months Ended |            | Nine Months Ended |            |
|---|--------------------|------------|-------------------|------------|
|   | September 30,      |            | September 30,     |            |
|   | 2014               | 2013       | 2014              | 2013       |
| Revenues  | \$51,013           | \$50,196   | \$153,353         | \$151,659  |
| Cost of revenues                                      | 14,272             | 25,532     | 46,305            | 61,303     |
| Amortization of acquired intangible assets            | 435                | 432        | 1,328             | 1,289      |
| Gross profit  | 36,306             | 24,232     | 105,720           | 89,067     |
| Operating expenses:                                   |                    |            |                   |            |
| Research and development                              | 4,423              | 3,028      | 13,138            | 10,376     |
| In-process research and development                   | 527                | —          | 527               | —          |
| Sales and marketing                                   | 18,649             | 18,149     | 56,545            | 55,804     |
| General and administrative                            | 10,213             | 11,443     | 33,676            | 34,018     |
| Amortization of acquired intangible assets            | 742                | 741        | 2,257             | 2,255      |
| Restructuring expenses                                | 20                 | 4,045      | 706               | 4,045      |
| Total operating expenses                              | 34,574             | 37,406     | 106,849           | 106,498    |
| Operating income (loss)                               | 1,732              | (13,174)   | (1,129)           | (17,431)   |
| Other income (expense):                               |                    |            |                   |            |
| Interest income                                       | 2                  | 2          | 8                 | 4          |
| Interest expense                                      | (3,875)            | (1,048)    | (9,310)           | (2,670)    |
| Other income (expense), net                           | (928)              | 210        | (1,230)           | (840)      |
| Total other income (expense)                          | (4,801)            | (836)      | (10,532)          | (3,506)    |
| Pretax net loss                                       | (3,069)            | (14,010)   | (11,661)          | (20,937)   |
| Income tax (benefit) provision                        | (28)               | 500        | 948               | 883        |
| Net loss  | \$(3,041)          | \$(14,510) | \$(12,609)        | \$(21,820) |
| Net loss per basic share                              | \$(0.03)           | \$(0.15)   | \$(0.13)          | \$(0.23)   |
| Net loss per diluted share                            | \$(0.04)           | \$(0.15)   | \$(0.13)          | \$(0.23)   |
| Shares used in calculating basic net loss per share   | 97,391             | 96,381     | 97,040            | 96,046     |
| Shares used in calculating diluted net loss per share | 98,329             | 96,381     | 97,258            | 96,046     |

See accompanying notes to unaudited condensed consolidated financial statements.

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

|  | Three Months Ended |             | Nine Months Ended |             |
|--|--------------------|-------------|-------------------|-------------|
|  | September 30,      |             | September 30,     |             |
|  | 2014               | 2013        | 2014              | 2013        |
| Net loss                                 | \$(3,041           | ) \$(14,510 | ) \$(12,609       | ) \$(21,820 |
| Foreign currency translation adjustments | (9,093             | ) 4,737     | (9,815            | ) 1,970     |
| Comprehensive income (loss)              | \$(12,134          | ) \$(9,773  | ) \$(22,424       | ) \$(19,850 |

See accompanying notes to unaudited condensed consolidated financial statements.

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

|   | Nine Months Ended September |             |
|---|-----------------------------|-------------|
|   | 30,                         |             |
|   | 2014                        | 2013        |
| Operating activities:   |                             |             |
| Net loss  | \$(12,609                   | ) \$(21,820 |
| Adjustments to reconcile net loss to net cash (used in) provided by operating activities: |                             |             |
| Depreciation and amortization   | 14,006                      | 19,964      |
| Stock-based compensation  | 3,641                       | 2,832       |
| Interest expense related to amortization of debt discount and debt issuance costs         | 4,354                       | 285         |
| Provision for doubtful accounts   | 443                         | 225         |
| Provision for excess and obsolete inventory   | 2,553                       | 10,842      |
| Deferred income tax expense (benefit)   | 338                         | (269        |
| Non-cash in-process research and development expenses                                     | 102                         | —           |
| Other non-cash items  | 2,655                       | 1,252       |
| Changes in operating assets and liabilities:  |                             |             |
| Restricted cash   | (2,001                      | ) —         |
| Accounts receivable   | 373                         | (1,704      |
| Inventories   | (3,134                      | ) (4,720    |
| Prepaid expenses and other current assets   | 4,143                       | 1,627       |
| Other assets  | (202                        | ) 57        |
| Accounts payable  | (261                        | ) (1,921    |
| Accrued expenses and other  | (34,684                     | ) 172       |
| Deferred revenues   | (1                          | ) (153      |
| Net cash (used in) provided by operating activities                                       | (20,284                     | ) 6,669     |
| Investing activities:   |                             |             |
| Purchases of property and equipment   | (7,751                      | ) (10,975   |
| Purchase of intangible assets   | —                           | (750        |
| Cash paid for acquisitions  | —                           | (4,000      |
| Cash received from sale of assets   | 300                         | —           |
| Net cash used in investing activities   | (7,451                      | ) (15,725   |
| Financing activities:   |                             |             |
| Borrowings under lines of credit  | 122,066                     | 109,283     |
| Repayments under lines of credit  | (115,068                    | ) (130,017  |
| Principal payments on capital lease obligations   | (605                        | ) (1,705    |
| Proceeds from notes payable   | 24,500                      | 28,000      |
| Principal payments on notes payable   | (3,836                      | ) —         |
| Net cash provided by financing activities   | 27,057                      | 5,561       |
| Effect of exchange rate changes on cash   | (498                        | ) (92       |
| Net decrease in cash  | (1,176                      | ) (3,587    |
| Cash at beginning of period   | 21,345                      | 22,241      |
| Cash at end of period   | \$20,169                    | \$18,654    |



See accompanying notes to unaudited condensed consolidated financial statements.

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

|  | Nine Months Ended September |         |
|--|-----------------------------|---------|
|  | 30,                         |         |
|  | 2014                        | 2013    |
| Supplemental disclosure of cash flow information:        |                             |         |
| Cash paid for interest                                   | \$4,074                     | \$2,759 |
| Cash paid for income taxes                               | \$487                       | \$804   |
| Purchases of property and equipment in accounts payable  | \$2,217                     | \$2,087 |
| Non-cash debt discount                                   | \$500                       | \$—     |
| Initial fair value of warrant liability                  | \$10,368                    | \$—     |
| Purchase of property and equipment through capital lease | \$759                       | \$—     |

See accompanying notes to unaudited condensed consolidated financial statements.



ALPHATEC HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. The Company and Basis of Presentation

The Company

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

Basis of Presentation

The accompanying condensed consolidated balance sheet as of December 31, 2013, which has been derived from audited financial statements, and the unaudited interim condensed consolidated financial statements have been prepared by the Company in accordance with U.S. generally accepted accounting principles (“GAAP”) and the rules and regulations of the Securities and Exchange Commission (“SEC”) related to a quarterly report on Form 10-Q. Certain information and note disclosures normally included in annual audited financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to those rules and regulations, although the Company believes that the disclosures made in this quarterly report on Form 10-Q are adequate to make the information not misleading. The interim unaudited condensed consolidated financial statements reflect all adjustments which, in the opinion of management, are necessary for a fair statement of the financial position and results of operations for the periods presented. All such adjustments are of a normal and recurring nature. These unaudited condensed consolidated financial statements should be read in conjunction with the Company’s audited financial statements for the year ended December 31, 2013, which are included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013 that was filed with the SEC on March 20, 2014.

Operating results for the three and nine months ended September 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014, or any other future periods.

The accompanying condensed consolidated financial statements have been prepared assuming that the Company will continue as a going concern. A going concern basis of accounting contemplates the recovery of the Company’s assets and the satisfaction of its liabilities in the normal course of business. Based on the Company’s annual operating plan, management believes that its cash as of September 30, 2014 of \$20.2 million combined with anticipated cash flow from operations through September 30, 2015 and other working capital, excluding common stock warrant liabilities, of \$37.0 million at September 30, 2014 and the Company’s available borrowings under the credit facilities with MidCap Financial, LLC (“MidCap”) and Deerfield Private Design Fund II, L.P., Deerfield Private Design International II, L.P., Deerfield Special Situations Fund, L.P. and Deerfield Special Situations International Master Fund, L.P. (collectively, “Deerfield”), will be sufficient to fund its cash requirements, including the required payments due under the Orthotec litigation settlement (Note 6), through at least September 30, 2015.

The Company’s amended and restated credit facility (the “Amended Credit Facility”) with MidCap contains financial covenants consisting of a monthly fixed charge coverage ratio, a senior leverage ratio and a total leverage ratio (see Note 5). Based on the Company’s current operating plan, the Company believes that it will be in compliance with the financial covenants of the Amended Credit Facility at least through September 30, 2015. However, there is no assurance that the Company will be able to do so. If the Company is not able to achieve its planned revenue or incurs costs in excess of its forecasts, it may be required to substantially reduce discretionary spending and it could be in

default of the Amended Credit Facility. There can be no assurance that the Company could obtain a waiver of such default from MidCap, that the Amended Credit Facility could be successfully renegotiated or that the Company could modify its operations to maintain liquidity. If the Company is unable to obtain any required waiver or amendments, MidCap would have the right to exercise remedies specified in the Amended Credit Facility, including accelerating the repayment of debt obligations. The Company may be forced to seek additional financing, which may include additional debt and/or equity financing or funding through other third party

agreements. There can be no assurances that additional financing would be available on acceptable terms or available at all. Furthermore, any equity financing may result in dilution to existing stockholders and any debt financing may involve agreements that include covenants limiting or restricting the Company's ability to take specific actions, such as incurring debt, making capital expenditures or declaring dividends.

## 2. Summary of Significant Accounting Policies

The Company's significant accounting policies are described in Note 2 to its audited consolidated financial statements for the year ended December 31, 2013, which are included in the Company's Annual Report on Form 10-K that was filed with the SEC on March 20, 2014. Except as discussed below, these accounting policies have not significantly changed during the nine months ended September 30, 2014.

### Restricted Cash

In March 2014, the Company borrowed and set aside cash for the payment of a portion of the Orthotec litigation settlement (see Note 6) as limited by the terms of the facility agreement that it entered into with Deerfield on March 17, 2014 (see Note 5). The Company classified this cash as restricted, because it may not be used for purposes other than payments of amounts due under the Orthotec litigation settlement agreement.

### In-Process Research and Development

In-process research and development ("IPR&D") consists of acquired research and development assets that are not part of an acquisition of a business and were not technologically feasible on the date the Company acquired them and had no alternative future use at that date or IPR&D assets acquired in a business acquisition that are determined to have no alternative future use. The Company expects all acquired IPR&D will reach technological feasibility, but there can be no assurance that commercial viability of these products will ever be achieved. The nature of the efforts to develop the acquired technologies into commercially viable products consists principally of planning, designing, developing and testing products in order to obtain regulatory approvals. If commercial viability were not achieved, the Company would likely look to other alternatives to provide these products. Until the technological feasibility of the acquired research and development assets are established, the Company expenses these costs. The Company expensed \$0.5 million as in-process research and development in the three and nine months ended September 30, 2014.

### Fair Value Measurements

The carrying amount of financial instruments consisting of cash, restricted cash, trade accounts receivable, prepaid expenses and other current assets, accounts payable, accrued expenses, accrued compensation and current portion of long-term debt included in the Company's consolidated financial statements are reasonable estimates of fair value due to their short maturities. Based on the borrowing rates currently available to the Company for loans with similar terms, management believes the fair value of long-term debt approximates its carrying value.

Authoritative guidance establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

- Level 1: Observable inputs such as quoted prices in active markets;
- Level 2: Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and
- Level 3: Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

The Company does not maintain any financial instruments that are considered to be Level 1 or Level 2 instruments as of September 30, 2014 or December 31, 2013. The Company classifies its common stock warrant liabilities within Level 3 of the fair value hierarchy because they are valued using valuation models with significant unobservable inputs. The following table provides a reconciliation of liabilities measured at fair value using significant unobservable inputs (Level 3) for the nine months ended September 30, 2014 (in thousands):

|                               | Common Stock<br>Warrant<br>Liabilities |
|-------------------------------|--|
| Balance at December 31, 2013  | \$—                                    |
| Issuance                      | 10,368                                 |
| Changes in fair value         | 292                                    |
| Balance at September 30, 2014 | \$10,660                               |

Common stock warrant liabilities are measured at fair value using the Black-Scholes option pricing valuation model. The assumptions used in the Black-Scholes option pricing valuation model for the common stock warrant liabilities were: (a) a risk-free interest rate based on the rates for U.S. Treasury zero-coupon bonds with maturities similar to those of the remaining contractual term of the warrants; (b) an assumed dividend yield of zero based on the Company's expectation that it will not pay dividends in the foreseeable future; (c) an expected term based on the remaining contractual term of the warrants; and (d) an expected volatility based upon the Company's historical volatility over the remaining contractual term of the warrants. The significant unobservable input used in measuring the fair value of the common stock warrant liabilities associated with the Deerfield Facility Agreement (defined below) is the expected volatility. Significant increases in volatility would result in a higher fair value measurement. The increase in the fair value of the common stock warrant liabilities as of September 30, 2014 was primarily driven by the increase in the Company's stock price at September 30, 2014 as compared to the Company's stock price on March 17, 2014, the date the common stock warrants were issued.

#### Warrants to Purchase Common Stock

Common stock warrants that contain compliance covenants and cash payment obligations are classified as common stock warrant liabilities on the consolidated balance sheet. The Company records the warrant liability at fair value and adjusts the carrying value of these common stock warrants to their estimated fair value at each reporting date with the increases or decreases in the fair value of such warrants at each reporting date recorded as other income (expense) in the consolidated statement of operations.

#### Recent Accounting Pronouncements

In March 2013, the Financial Accounting Standards Board ("FASB") issued guidance on a parent company's accounting for the cumulative translation adjustment upon derecognition of a subsidiary or group of assets within a foreign entity. This new guidance requires that the parent release any related cumulative translation adjustment into net income only if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets had resided. The amendments became effective for the Company beginning January 1, 2014. The Company adopted this guidance and the adoption did not have any impact on the Company's financial statements.

In April 2014, the FASB issued new guidance related to reporting discontinued operations. This new standard raises the threshold for a disposal to qualify as a discontinued operation and requires new disclosures of both discontinued operations and certain other disposals that do not meet the definition of a discontinued operation. The new standard is effective for fiscal years beginning on or after December 15, 2014. The Company is evaluating the impact, if any, of adopting this new accounting standard on its financial statements.

In May 2014, the FASB issued new accounting guidance related to revenue recognition. This new standard will replace all current U.S. GAAP guidance on this topic and eliminate all industry-specific guidance. The new revenue recognition standard provides a unified model to determine when and how revenue is recognized. The core principle is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration for which the entity expects to be entitled in exchange for those goods or services. This guidance will be effective for the Company beginning January 1, 2017 and can be applied either

retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. The Company is evaluating the impact of adopting this new accounting standard on its financial statements.



In August 2014, the FASB issued guidance related to disclosures of uncertainties about an entity's ability to continue as a going concern. The guidance requires management to evaluate whether there are conditions and events that raise substantial doubt about the entity's ability to continue as a going concern within one year after the financial statements are issued. Management will be required to make this evaluation for both annual and interim reporting periods and will have to make certain disclosures if it concludes that substantial doubt exists or when its plans alleviate substantial doubt about the entity's ability to continue as a going concern. Substantial doubt exists when relevant conditions and events, considered in the aggregate, indicate that it is probable that the entity will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued. The guidance is effective for annual periods ending after December 15, 2016 and for interim reporting periods starting in the first quarter 2017, with early adoption permitted. The Company is currently evaluating the impact of this guidance and expects to adopt the standard for the annual reporting period ended December 31, 2016.

### 3. Select Balance Sheet Details

Accounts Receivable, net

Accounts receivable, net consist of the following (in thousands):

|                                 | September 30,<br>2014 | December 31,<br>2013 |
|---------------------------------|-----------------------|----------------------|
| Accounts receivable             | \$41,062              | \$42,443             |
| Allowance for doubtful accounts | (1,009                | ) (1,048             |
| Accounts receivable, net        | \$40,053              | \$41,395             |

Inventories, net

Inventories, net consist of the following (in thousands):

|                 | September 30, 2014 |                                       |            | December 31, 2013 |                                       |            |
|-----------------|--------------------|---------------------------------------|------------|-------------------|---------------------------------------|------------|
|                 | Gross              | Reserve for<br>excess and<br>obsolete | Net        | Gross             | Reserve for<br>excess and<br>obsolete | Net        |
| Raw materials   | \$4,526            | \$—                                   | \$4,526    | \$4,375           | \$—                                   | \$4,375    |
| Work-in-process | 1,017              | —                                     | 1,017      | 531               | —                                     | 531        |
| Finished goods  | 57,317             | (20,874                               | ) 36,443   | 60,979            | (23,946                               | ) 37,033   |
| Inventories     | \$62,860           | \$(20,874                             | ) \$41,986 | \$65,885          | \$(23,946                             | ) \$41,939 |

Property and Equipment, net

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

|  | Useful lives<br>(in years) | September 30,<br>2014 | December 31,<br>2013 |
|--|----------------------------|-----------------------|----------------------|
| Surgical instruments                           | 4                          | \$63,019              | \$62,636             |
| Machinery and equipment                        | 7                          | 15,461                | 14,692               |
| Computer equipment                             | 3                          | 3,193                 | 3,357                |
| Office furniture and equipment                 | 5                          | 3,823                 | 3,703                |
| Leasehold improvements                         | various                    | 3,719                 | 4,161                |
| Building                                       | 39                         | 72                    | 52                   |
| Land   | n/a                        | 10                    | 10                   |
| Construction in progress                       | n/a                        | 1,016                 | 1,228                |
|  |                            | 90,313                | 89,839               |
| Less accumulated depreciation and amortization |                            | (63,803               | ) (61,809            |
| Property and equipment, net                    |                            | \$26,510              | \$28,030             |

Total depreciation expense was \$2.9 million and \$3.7 million for the three months ended September 30, 2014 and 2013, respectively. Total depreciation expense was \$9.2 million and \$10.9 million for the nine months ended September 30, 2014 and 2013, respectively. At September 30, 2014, assets recorded under capital leases of \$3.2 million were included in the machinery and equipment balance. At December 31, 2013, assets recorded under capital leases of \$1.8 million were included in the machinery and equipment balance and \$0.6 million were included in the construction in progress balance. Amortization of assets under capital leases was included in depreciation expense.

Intangible Assets, net

Intangible assets, net consist of the following (in thousands except for useful lives):

|                               | Useful lives<br>(in years) | September 30,<br>2014 | December 31,<br>2013 |
|-------------------------------|----------------------------|-----------------------|----------------------|
| Developed product technology  | 3-8                        | \$22,880              | \$23,633             |
| Distribution rights           | 3                          | 2,270                 | 2,343                |
| Intellectual property         | 5                          | 1,004                 | 1,004                |
| License agreements            | 1-7                        | 16,716                | 17,686               |
| Core technology               | 10                         | 4,740                 | 5,137                |
| Trademarks and trade names    | 3-9                        | 3,674                 | 3,920                |
| Customer-related              | 12-15                      | 21,026                | 22,161               |
| Distribution network          | 10-12                      | 4,027                 | 4,027                |
| Physician education programs  | 10                         | 2,916                 | 3,160                |
| Supply agreement              | 10                         | 225                   | 225                  |
|                               |                            | 79,478                | 83,296               |
| Less accumulated amortization |                            | (47,050               | ) (44,232            |
| Intangible assets, net        |                            | \$32,428              | \$39,064             |

Total amortization expense was \$1.6 million and \$3.7 million for the three months ended September 30, 2014 and 2013, respectively. Total amortization expense was \$4.8 million and \$9.1 million for the nine months ended September 30, 2014 and 2013, respectively.

Future amortization expense related to intangible assets as of September 30, 2014 is as follows (in thousands):

Year Ending December 31,

|                   |          |
|-------------------|----------|
| Remainder of 2014 | \$1,493  |
| 2015              | 5,792    |
| 2016              | 5,281    |
| 2017              | 4,984    |
| 2018              | 3,127    |
| Thereafter        | 11,751   |
|                   | \$32,428 |

## Accrued Expenses

Accrued expenses consist of the following (in thousands):

|                        | September 30,<br>2014 | December 31,<br>2013 |
|------------------------|-----------------------|----------------------|
| Legal                  | \$570                 | \$2,139              |
| Accounting             | 949                   | 928                  |
| Severance              | 459                   | 297                  |
| Restructuring          | 730                   | 9,170                |
| Sales milestones       | 96                    | 1,828                |
| Accrued taxes          | 811                   | 1,120                |
| Deferred rent          | 884                   | 1,163                |
| Royalties              | 2,443                 | 2,347                |
| Commissions            | 5,275                 | 6,180                |
| Payroll and related    | 8,013                 | 9,369                |
| Litigation settlements | 8,386                 | 22,600               |
| Accrued interest       | 887                   | 416                  |
| Other                  | 5,492                 | 5,439                |
| Total accrued expenses | \$34,995              | \$62,996             |
| Goodwill               |                       |                      |

The changes in the carrying amount of goodwill from December 31, 2013 through September 30, 2014 are as follows (in thousands):

|   |           |
|---|-----------|
| Balance at December 31, 2013                | \$183,004 |
| Effect of foreign exchange rate on goodwill | (7,915 )  |
| Balance at September 30, 2014               | \$175,089 |

## 4. License and Consulting Agreements

The Company's license and consulting agreements are described in Note 5 to its audited consolidated financial statements for the year ended December 31, 2013, which are included in its Annual Report on Form 10-K which was filed with the SEC on March 20, 2014.

## OsseoFix Spinal Fracture Reduction License Agreement

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

In August 2014, the Company entered a third amendment (the "Third Amendment") to the License Agreement. Pursuant to the Third Amendment: (i) the royalty rate paid by the Company for the net sales of licensed products is a fixed

amount per

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quarter through December 31, 2016; (ii) the royalty rate starting in 2017 will be increased from 7.0% to 8.5%; (iii) starting in 2017, the minimum royalty obligation is \$0.2 million per year, with such minimum royalty obligation being further reduced starting in 2018; (iv) the territory is amended so that the United States is removed from the territory in which the Company can sell and market licensed products; (v) all obligations of the Company to pursue a clinical trial in the United States are deleted; and (vi) all milestone payments based on the achievement of certain sales milestones are deleted. In connection with this amendment the Company reversed the \$1.7 million accrual it had recorded for the sales milestone payment into cost of goods sold for the three and nine months ended September 30, 2014.

#### Asset Purchase Agreement

In July 2014, the Company entered into an asset purchase and product development services agreement (the "Asset Agreement") whereby the Company purchased rights to the conceptual design for an intervertebral implant device. The financial terms of the Agreement include payments in cash and the Company's common stock upon achievement of various milestones. The Company treated this arrangement as an asset acquisition. In the three months ended September 30, 2014, the Company made cash payments totaling \$0.2 million and issued 72,992 shares of the Company's common stock valued at \$0.1 million. The Company recognized the cash and stock payments of \$0.3 million as in-process research and development expense in the three and nine months ended September 30, 2014.

#### 5. Debt

##### MidCap Facility Agreement

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

Pursuant to the Amended Credit Facility, the Company increased the borrowing limit from \$50 million to \$73 million. The Company also extended the maturity to August 2016. The Amended Credit Facility consists of a \$33 million term loan, \$28 million of which was drawn at closing and the remaining \$5 million of which was drawn in April 2014, and a revolving line of credit with a maximum borrowing base of \$40 million, of which \$31.8 million was outstanding at September 30, 2014. The Company used the term loan proceeds of \$28 million drawn at closing to repay a portion of the outstanding balance on the prior revolving line of credit.

The term loan interest rate is priced at the London Interbank Offered Rate ("LIBOR") plus 8.0%, subject to a 9.5% floor, and the revolving line of credit interest rate remains priced at LIBOR plus 6.0%, reset monthly. At September 30, 2014, the revolving line of credit carried an interest rate of 6.2% and the term loan carries an interest rate of 9.5%. The borrowing base is determined, from time to time, based on the value of domestic eligible accounts receivable and domestic eligible inventory. As collateral for the Amended Credit Facility, the Company granted MidCap a security interest in substantially all of its assets, including all accounts receivable and all securities evidencing its interests in its subsidiaries. In addition to monthly payments of interest, monthly repayments of \$0.3 million of the principal for the term loan were made beginning in October 2013, increasing to \$0.5 million beginning in October 2014, and are due through maturity, with the remaining principal due upon maturity.

In connection with the execution of the Amended Credit Facility, the Company incurred an additional \$0.4 million in costs that were capitalized as debt issuance costs within the unaudited consolidated balance sheet as of September 30, 2013. At September 30, 2014, \$0.5 million remains as unamortized debt issuance costs related to the prior and Amended Credit Facility within the unaudited consolidated balance sheet, which will be amortized over the remaining term of the Amended Credit Facility.

The Amended Credit Facility includes traditional lending and reporting covenants including a fixed charge coverage ratio, a senior leverage ratio and a total leverage ratio to be maintained by the Company. The Amended Credit Facility also includes several potential events of default, such as payment default and insolvency conditions, which could cause interest to be charged at a rate which is up to five percentage points above the rate effective immediately before the event of default or result in MidCap's right to declare all outstanding obligations immediately due and payable.

In January 2013, the Company entered into a limited waiver and limited consent agreement with MidCap (the "Waiver"). Under the Waiver, MidCap gave the Company its consent to waive certain provisions of the Credit Facility in connection with the acquisition of the assets of Phygen, LLC ("Phygen") and related to the maintenance of cash

balances in the U.S. In February 2013, the Company and MidCap entered into a first amendment to the Credit Facility (the "First Amendment to the Credit Facility"). The First Amendment to the Credit Facility allowed the Company to exclude payments related to the Phygen acquisition and the settlement agreement with Cross Medical Products, LLC ("Cross") from calculation of the fixed charge

coverage ratio and the senior leverage ratio. In conjunction with the First Amendment to the Credit Facility, the Company paid MidCap a fee of \$0.1 million. In July 2013, the Company entered into a second limited waiver and limited consent agreement with MidCap (the "Second Waiver"). Under the Second Waiver, MidCap gave the Company its consent to waive certain provisions of the Credit Facility related to the maintenance of cash balances in the U.S. for past periods through September 30, 2013. On August 30, 2013, the Company entered into the Amended Credit Agreement with MidCap.

On March 17, 2014, the Company entered into a first amendment to the Amended Credit Facility with MidCap (the "First Amendment to the Amended Credit Facility"). Under the First Amendment to the Amended Credit Facility, MidCap gave the Company its consent to enter into the Facility Agreement (defined below) and make settlement payments in connection with the Orthotec litigation. The First Amendment to the Amended Credit Facility also added a total leverage ratio financial covenant. The Company was in compliance with all of the covenants of the Amended Credit Facility as of September 30, 2014.

#### Deerfield Facility Agreement

On March 17, 2014, the Company entered into a facility agreement (the "Facility Agreement") with Deerfield, pursuant to which Deerfield agreed to loan the Company up to \$50 million, subject to the terms and conditions set forth in the Facility Agreement. Under the terms of the Facility Agreement, the Company has the option, but is not required, upon certain conditions to draw the entire amount available under the Facility Agreement, at any time until January 30, 2015 (the "Draw Period"), provided that the initial draw be used for a portion of the payments made in connection with the Orthotec settlement described in Note 6 below. Following such initial draw down, the Company may draw down additional amounts under the Facility Agreement up to an aggregate \$15 million for working capital or general corporate purposes in \$2.5 million increments until the end of the Draw Period. The Company has agreed to pay Deerfield, upon each disbursement of funds under the Facility Agreement, a transaction fee equal to 2.5% of the principal amount of the funds disbursed. Amounts borrowed under the Facility Agreement bear interest at a rate of 8.75% per annum and are payable on the third, fourth and fifth anniversary date of the first amount borrowed under the Facility Agreement, with the final payment due on March 20, 2019.

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

In connection with the execution of the Facility Agreement on March 17, 2014, the Company issued to Deerfield warrants to purchase an aggregate of 6,250,000 shares of the Company's common stock (the "Initial Warrants") (See Note 8). Additionally, each disbursement borrowing under the Facility Agreement shall be accompanied by the issuance to Deerfield of warrants to purchase up to 10,000,000 shares of the Company's common stock, in proportion to the amount of draw compared to the total \$50 million facility (the "Draw Warrants") (See Note 8).

On March 20, 2014, the Company made an initial draw of \$20 million under the Facility Agreement and received net proceeds of \$19.5 million to fund the portion of the Orthotec settlement payment obligations that are due in 2014. The \$0.5 million transaction fee is recorded as a debt discount and is being amortized over the term of the draw, which ends March 20, 2019. In connection with this borrowing, the Company issued 4,000,000 Draw Warrants, which were valued at \$4.7 million and recorded as a debt discount and is being amortized over the term of the \$20 million draw. Additionally, \$2.3 million of the value of the Initial Warrants was reclassified as a debt discount and is being amortized through interest expense over the term of the debt using the effective interest method. Orthotec settlement payments of \$17.5 million were made in the nine months ending September 30, 2014, leaving remaining proceeds of \$2.0 million, which were classified as restricted cash, as their use is limited under the terms of the Facility Agreement for the payments of amounts due under the Orthotec litigation settlement agreement. Additionally, a payment of \$1.1 million was made on October 1, 2014. The amounts borrowed under the Facility Agreement are due in three equal annual payments beginning March 20, 2017.





Principal payments on debt are as follows as of September 30, 2014 (in thousands):

|   |  |          |
|---|--|----------|
| Year Ending December 31,                |  |          |
| Remainder of 2014                       |  | \$2,018  |
| 2015                                    |  | 6,869    |
| 2016                                    |  | 54,894   |
| 2017                                    |  | 6,667    |
| 2018                                    |  | 6,667    |
| Thereafter                              |  | 6,666    |
| Total                                   |  | 83,781   |
| Add: capital lease principal payments   |  | 1,491    |
| Less: debt discount                     |  | (6,613 ) |
| Total                                   |  | 78,659   |
| Less: current portion of long-term debt |  | (8,042 ) |
| Long-term debt, net of current portion  |  | \$70,617 |

6. Commitments and Contingencies

Leases

The Company leases certain equipment under capital leases which expire on various dates through June 2017. The leases bear interest at rates ranging from 6.6% to 9.6% per annum, are generally due in monthly principal and interest installments and are collateralized by the related equipment. The Company also leases its buildings and certain equipment and vehicles under operating leases which expire on various dates through January 2019. Future minimum annual lease payments under such leases are as follows as of September 30, 2014 (in thousands):

|   |           |         |
|---|-----------|---------|
| Year Ending December 31,                | Operating | Capital |
| Remainder of 2014                       | \$877     | \$181   |
| 2015                                    | 3,228     | 662     |
| 2016                                    | 1,827     | 623     |
| 2017                                    | 377       | 183     |
| 2018                                    | 68        | —       |
| Thereafter                              | 4         | —       |
|   | \$6,381   | 1,649   |
| Less: amount representing interest      |           | (158 )  |
| Present value of minimum lease payments |           | 1,491   |
| Current portion of capital leases       |           | (586 )  |
| Capital leases, less current portion    |           | \$905   |

Rent expense under operating leases for the three months ended September 30, 2014 and 2013 was \$0.8 million and \$0.9 million, respectively. Rent expense under operating leases for the nine months ended September 30, 2014 and 2013 was \$2.6 million and \$2.9 million, respectively.

## Litigation

The Company previously reported that on March 15, 2014, the Company had entered into a binding term sheet (the "Binding Term Sheet") to resolve the Orthotec, LLC v. Surgiview, S.A.S, et al. matter in the Superior Court of California, Los Angeles County and related litigation matters (the "Orthotec Settlement"). Both the Orthotec litigation matter and the Orthotec Settlement have been previously reported. Pursuant to the terms contained in the Binding Term Sheet, the Company agreed to pay Orthotec, LLC \$49 million in cash, including initial cash payments totaling \$1.75 million, which the Company previously paid in March 2014, and an additional lump sum payment of \$15.75 million, which the Company previously paid in June 2014. The Company agreed to pay the remaining \$31.5 million in 28 quarterly installments of \$1.1 million and then one additional quarterly installment of \$700,000, commencing October 1, 2014. The Company has the right to prepay the amounts due without penalty. In addition, the unpaid balance of the amounts due will accrue interest at the rate of 7% per year beginning May 15, 2014 until the amounts due are paid in full. The accrued but unpaid interest will be paid in quarterly installments of \$1.1 million (or the full amount of the accrued but unpaid interest if less than \$1.1 million) following the full payment of the \$31.5 million in quarterly installments described above. No interest will accrue on the accrued interest. The Binding Term Sheet provided for mutual releases of all claims in the Orthotec, LLC v. Surgiview, S.A.S, et al. matter in the Superior court of California, Los Angeles County and all other related litigation matters involving the Company, its directors and affiliates.

On September 26, 2014, the Company entered into a Settlement and Release Agreement, dated as of August 13, 2014, by and among the Company and its direct subsidiaries, including Alphatec Spine, Inc., Alphatec Holdings International C.V., Scient'x S.A.S. and Surgiview S.A.S.; HealthpointCapital, LLC, HealthpointCapital Partners, L.P., HealthpointCapital Partners II, L.P., John H. Foster and Mortimer Berkowitz III; and Orthotec, LLC and Patrick Bertranou, (the "Settlement Agreement"). The Settlement Agreement contains substantially the same business terms as the Binding Term Sheet set forth above, and supersedes the Binding Term Sheet.

On August 10, 2010, a purported securities class action complaint was filed in the United States District Court for the Southern District of California on behalf of all persons who purchased the Company's common stock between December 19, 2009 and August 5, 2010 against the Company and certain of its directors and officers alleging violations of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and Rule 10b-5 promulgated thereunder. On February 17, 2011, an amended complaint was filed against the Company and certain of its directors and officers adding alleged violations of the Securities Act of 1933 (the "Securities Act"), as amended. HealthpointCapital, Jefferies & Company, Inc., Canaccord Adams, Inc., Cowen and Company, Inc., and Lazard Capital Markets LLC are also defendants in this action. The complaint alleges that the defendants made false or misleading statements and failed to disclose material facts about the Company's business, financial condition, operations and prospects, particularly relating to the Scient'x transaction and the Company's financial guidance following the closing of the acquisition. The complaint seeks unspecified monetary damages, attorneys' fees, and other unspecified relief. The Company filed a motion to dismiss the amended complaint on April 18, 2011. The district court granted the motion to dismiss with leave to amend on March 22, 2012. On April 19, 2012, the lead plaintiff filed a Second Amended Complaint alleging violations of Sections 10(b) and 20(a) of the Exchange Act and violations of Section 11, 12(a)(2), and 15 of the Securities Act against the same named defendants. On May 3, 2012, the Company filed a motion to dismiss the Second Amended Complaint. The district court granted that motion without leave to amend and entered final judgment in the Company's favor on March 28, 2013. On April 17, 2013, the lead plaintiff filed a notice of appeal to the United States Court of Appeals for the Ninth Circuit. The appeal has been fully briefed. The Company believes that the claims are without merit and it intends to vigorously defend itself against this complaint. However, the outcome of the litigation cannot be predicted at this time and any outcome that is adverse to the Company, regardless of who the defendant is, could have a significant adverse effect on its financial condition and results of operations.

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

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

At September 30, 2014, the probable outcome of any of the aforementioned litigation matters that have not reached a settlement cannot be determined nor can the Company estimate a range of potential loss. Accordingly, in accordance with the

authoritative guidance on the evaluation of contingencies, the Company has not recorded an accrual related to any litigation matters that have not reached a settlement. The Company is and may become involved in various other legal proceedings arising from its business activities. While management does not believe the ultimate disposition of the above matters that have not yet been settled will have a material adverse impact on the Company's consolidated results of operations, cash flows or financial position, litigation is inherently unpredictable, and depending on the nature and timing of these proceedings, an unfavorable resolution could materially affect the Company's future consolidated results of operations, cash flows or financial position in a particular period.

#### Royalties

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

#### 7. Net Loss Per Share

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

|   | Three Months Ended<br>September 30, |              | Nine Months Ended<br>September 30, |              |
|---|-------------------------------------|--------------|------------------------------------|--------------|
|   | 2014                                | 2013         | 2014                               | 2013         |
| Numerator:  |                                     |              |                                    |              |
| Net loss for basic earnings per share                         | \$ (3,041                           | ) \$ (14,510 | ) \$ (12,609                       | ) \$ (21,820 |
| Decrease in fair value of warrants                            | (513                                | ) —          | (520                               | ) —          |
| Diluted net loss applicable to common stockholders            | \$ (3,554                           | ) \$ (14,510 | ) \$ (13,129                       | ) \$ (21,820 |
| Denominator:  |                                     |              |                                    |              |
| Weighted average common shares outstanding                    | 98,126                              | 97,318       | 97,864                             | 96,940       |
| Weighted average unvested common shares subject to repurchase | (735                                | ) (937       | ) (824                             | ) (894       |
| Weighted average common shares outstanding—basic              | 97,391                              | 96,381       | 97,040                             | 96,046       |
| Effect of dilutive securities:                                |                                     |              |                                    |              |
| Conversion of preferred stock                                 | —                                   | —            | —                                  | —            |
| Options   | —                                   | —            | —                                  | —            |
| Warrants  | 938                                 | —            | 218                                | —            |
| Weighted average common shares outstanding—diluted            | 98,329                              | 96,381       | 97,258                             | 96,046       |
| Net loss per share:   |                                     |              |                                    |              |
| Basic   | \$ (0.03                            | ) \$ (0.15   | ) \$ (0.13                         | ) \$ (0.23   |
| Diluted   | \$ (0.04                            | ) \$ (0.15   | ) \$ (0.13                         | ) \$ (0.23   |

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

|                                   | Three Months Ended |       | Nine Months Ended |       |
|-----------------------------------|--------------------|-------|-------------------|-------|
|                                   | September 30,      |       | September 30,     |       |
|                                   | 2014               | 2013  | 2014              | 2013  |
| Options to purchase common stock  | 6,904              | 2,383 | 7,199             | 4,355 |
| Unvested restricted share awards  | 735                | 937   | 824               | 894   |
| Warrants to purchase common stock | 594                | 594   | 6,844             | 594   |
| Total                             | 8,233              | 3,914 | 14,867            | 5,843 |

## 8. Equity Transactions

### Warrants

In connection with the execution of the Facility Agreement, on March 17, 2014, the Company issued to Deerfield warrants to purchase an aggregate of 6,250,000 shares of the Company's common stock immediately exercisable at an exercise price equal to \$1.39 (the "Initial Warrants") expiring on March 17, 2020. The number of shares of common stock into which the Initial Warrants are exercisable and the exercise price will be adjusted to reflect any stock splits, payment of stock dividends, recapitalizations, reclassifications or other similar adjustments in the number of outstanding shares of the Company's common stock. The warrants have the same dividend rights to the same extent as if the warrants had been exercised for shares of common stock.

Each disbursement borrowing under the Facility Agreement shall be accompanied by the issuance to Deerfield of additional warrants to purchase up to an aggregate of 10,000,000 shares of the Company's common stock, at an exercise price equal to the lesser of the Initial Warrant exercise price or the average daily volume weighted average price per share of the Company's common stock for the 15 days following the request for borrowing (the "Draw Warrants"). The number of Draw Warrants issued for each draw will be in proportion to the amount of draw compared to the total \$50 million facility.

The Initial Warrants were valued on March 17, 2014 using a Black-Scholes option pricing model that resulted in a value of \$5.7 million, which was recorded as a current liability with an offset to a deferred charge asset and will be amortized on a straight line basis through interest expense over the term of the Facility Agreement commitment period ending January 30, 2015. To the extent the Company draws on the \$50 million Facility Agreement, a proportionate amount of the unamortized current deferred charge will be reclassified as debt discount and amortized through interest expense over the term of the debt using the effective interest method.

On March 20, 2014, the Company made an initial draw of \$20 million under the Facility Agreement and received net proceeds of \$19.5 million to fund the portion of the Orthotec settlement payment obligations that are due in 2014. In connection with this borrowing, the Company issued Draw Warrants to purchase 4,000,000 shares of common stock at an exercise price of \$1.39. The Draw Warrants were valued at \$4.7 million using the Black-Scholes option pricing model, which was recorded as a current liability with an offset to debt discount. In connection with the \$20 million draw, \$2.3 million of the deferred charge recorded upon the issuance of the Initial Warrants was reclassified as a debt discount.

As of September 30, 2014, the 10,250,000 outstanding Initial Warrants and Draw Warrants were revalued to their fair value with a charge to other income (expense) of \$0.5 million and (\$0.3 million) for the three and nine months ended September 30, 2014. The warrant liability of \$10.7 million is recorded as common stock warrant liabilities within current liabilities on the condensed consolidated balance sheet as of September 30, 2014.

At September 30, 2014, our outstanding warrants were valued using the Black-Scholes option pricing model. This is a Level 3 measurement using the following assumptions:

|                         | September 30, 2014 |   |
|-------------------------|--------------------|---|
| Risk-free interest rate | 1.9                | % |
| Dividend yield          | —                  | % |
| Expected volatility     | 63                 | % |
| Expected life (years)   | 5.5                |   |



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

In July 2014, the Company granted 932,000 performance-based restricted stock units ("PSUs") to certain employees under its 2005 Employee, Director and Consultant Stock Plan (the "2005 Plan"). The PSUs vest based upon the Company's achievement of certain performance goals over the period from July 1, 2014 through December 31, 2016. The number of PSUs that may vest varies between 0%-200% based on the achievement of such goals. The PSUs were valued at \$1.42 per share based on the closing price of the Company's common stock on the date of grant. For purposes of measuring compensation expense, the amount of PSUs ultimately expected to vest is estimated at each reporting date based on management's expectations regarding the relevant performance criteria. The recognition of compensation expense associated with PSUs requires judgment in assessing the probability of meeting the performance goals, as well as defined criteria for assessing achievement of the performance-related goals.

#### 10. Income Taxes

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

The Company recognizes interest and penalties related to uncertain tax positions as a component of the income tax provision. The Company's unrecognized tax benefits decreased less than \$0.1 million during the nine months ended September 30, 2014. The decrease in unrecognized tax benefits during the nine months ended September 30, 2014 was primarily related to foreign currency fluctuations and changes in prior year uncertain tax positions within the Company's foreign subsidiaries, partially offset by an increase related to state research credits and uncertain tax positions within the Company's foreign subsidiaries. The unrecognized tax benefits at September 30, 2014 and December 31, 2013 were \$7.8 million. With the facts and circumstances currently available to the Company, it is reasonably possible that the amount that could reverse over the next 12 months is insignificant. Additionally, the French restructuring (see Note 11) may result in limitations on the Company's ability to utilize its French net operating loss carryforwards to offset future taxable income.

The income tax provision consists primarily of income tax provisions related to state income taxes, the tax effect of changes in deferred tax liabilities associated with tax deductible goodwill and operations in other foreign jurisdictions where the Company operates.

The Company is not currently under examination by the Internal Revenue Service, or by foreign, state or local tax authorities.

#### 11. Segment and Geographical Information

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

During the three and nine months ended September 30, 2014 and 2013, the Company operated in two geographic regions, the U.S. and International, which consists of locations outside of the U.S. In the International geographic region, sales in Japan for the three and nine months ended September 30, 2014 totaled \$8.5 million and \$23.8 million, respectively, which represented greater than 10 percent of the Company's consolidated revenues. In the International geographic region, sales in Japan for the three and nine months ended September 30, 2013 totaled \$7.3 million and \$20.8 million which represented greater than 10 percent of the Company's consolidated revenues.

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

|                             | Three Months Ended |          | Nine Months Ended |           |
|-----------------------------|--------------------|----------|-------------------|-----------|
|                             | September 30,      |          | September 30,     |           |
|                             | 2014               | 2013     | 2014              | 2013      |
| United States               | \$34,808           | \$33,696 | \$101,376         | \$99,249  |
| International               | 16,205             | 16,500   | 51,977            | 52,410    |
| Total consolidated revenues | \$51,013           | \$50,196 | \$153,353         | \$151,659 |

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

|                           | September 30, | December 31, |
|---------------------------|---------------|--------------|
|                           | 2014          | 2013         |
| United States             | \$200,012     | \$196,383    |
| International             | 148,590       | 169,247      |
| Total consolidated assets | \$348,602     | \$365,630    |

## 12. Restructuring

On September 16, 2013, the Company announced that Scient'x began a process to significantly restructure its business operations in France in an effort to improve operating efficiencies and rationalize its cost structure. The restructuring included a reduction in Scient'x's workforce and closing of the manufacturing facilities in France. The Company has recorded total costs of \$10.4 million to date associated with this restructuring, which includes employee severance, social plan benefits and related taxes, facility closing costs, manufacturing transfer costs, and contract termination costs. In accordance with ASC Topic 420, Accounting for Costs Associated with Exit or Disposal Activities, and ASC Topic 712, Non Retirement Postemployment Benefits, the Company has recorded a restructuring charge accrual in accrued expenses of \$0.7 million within the condensed consolidated balance sheet as of September 30, 2014.

Additionally, the Company has recorded restructuring expense of \$0.7 million within the condensed consolidated statement of operations for the nine months ending September 30, 2014. The Company has substantially completed the activities associated with the restructuring as of September 30, 2014, and a substantial portion has been paid.

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

|                           | Accrued Balance at | Expensed           | Paid and   | Accrued Balance at | Total Costs |
|---------------------------|--------------------|--------------------|------------|--------------------|-------------|
|                           | December 31, 2013  | September 30, 2014 | Other      | September 30, 2014 | Incurred    |
| Social plan costs         | \$9,170            | \$197              | \$(8,637 ) | \$730              | \$9,450     |
| Other restructuring costs | —                  | 509                | (509 )     | —                  | 921         |
| Total                     | \$9,170            | \$706              | \$(9,146 ) | \$730              | \$10,371    |

## 13. Related Party Transactions

For the nine months ended September 30, 2014, the Company incurred expenses of \$0.2 million and had a liability of \$0.2 million payable to HealthpointCapital, LLC for travel and administrative expenses.

The Company has entered into indemnification agreements with certain of its directors which are named defendants in the New York Orthotec matter (see Note 6 – Commitments and Contingencies – Litigation). The indemnification agreements require the Company to indemnify these individuals to the fullest extent permitted by applicable law and to advance expenses incurred by them in connection with any proceeding against them with respect to which they may be entitled to indemnification by the Company. For the nine months ended September 30, 2014 and 2013, the Company incurred legal expenses of less than \$0.1 million and \$1.3 million, respectively, in connection with the Company's indemnification obligations to two former directors of Scient'x in the New York Orthotec matter.

### Shareholder Note Receivable

On March 15, 2014, the Company, Orthotec, LLC and certain other parties, including certain directors and affiliates of the Company, entered into the Binding Term Sheet to resolve the OrthoTec, LLC v. Surgiview, S.A.S., et al. matter in the Superior





Court of California, Los Angeles County, and related matters. On September 26, 2014, the parties entered into the Settlement Agreement, which superceded the Binding Term Sheet (see Note 6 – Commitments and Contingencies – Litigation). Pursuant to the Settlement Agreement, the Company agreed to pay Orthotec \$49 million in cash, with initial cash payments of \$1.75 million paid in March 2014 and \$15.75 million paid in June 2014. The remaining \$31.5 million will be paid to Orthotec in 28 quarterly installments of \$1.1 million and then one additional quarterly installment of \$0.7 million, commencing October 1, 2014. In June 2014, the Company and HealthpointCapital entered into an agreement for joint payment of settlement whereby HealthpointCapital has agreed to contribute \$5 million to the \$49 million settlement amount.

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

You should read the following in conjunction with our unaudited condensed consolidated financial statements and the related notes thereto that appear elsewhere in this Quarterly Report on Form 10-Q and the audited consolidated financial statements and notes thereto and under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K filed with the Securities and Exchange Commission, or SEC, on March 20, 2014. In addition to historical information the following management's discussion and analysis of our financial condition and results of operations includes forward-looking information that involve risks, uncertainties, and assumptions. Our actual results and the timing of events could differ materially from those anticipated by these forward-looking statements as a result of many factors, such as those set forth in our Annual Report on Form 10-K for the year ending December 31, 2013 and any updates to those risk factors filed from time to time in our subsequent periodic and current reports filed with the SEC.

Overview

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

Revenue and Expense Components

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

Revenues. We derive our revenues primarily from the sale of spinal surgery implants used in the treatment of spine disorders. Spinal implant products include spine screws and complementary products, vertebral body replacement devices, plates, products to treat vertebral compression fractures and bone grafting materials. Our revenues are generated by our direct sales force and independent distributors. Our products are requested directly by surgeons and shipped and billed to hospitals and surgical centers. In general, except for those countries where we have a direct sales force (the U.S., Japan, Italy and the United Kingdom), we use independent distributors that purchase our products and market them to surgeons. A majority of our business is conducted with customers within markets in which we have experience and with payment terms that are customary to our business. If we offer payment terms greater than our customary business terms or begin operating in a new market, revenues are deferred until the earlier of when payments become due or cash is received from the related distributors.

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

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

In-process research and development expense. In-process research and development expense consists of acquired research and development assets that were not part of an acquisition of a business and were not part of a business acquisition and were not technically feasible on the date we acquired such technology, provided that technology did

not have any alternative future use at that date.

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

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

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

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

Income tax (benefit) provision . Income tax (benefit) provision consists primarily of state and foreign income taxes and the tax effect of changes in deferred tax liabilities associated with tax goodwill.

#### Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations is based upon our unaudited condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the U.S. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures. On an on-going basis, we evaluate our estimates and assumptions, including those related to revenue recognition, allowances for accounts receivable, inventories, goodwill and intangible assets, stock-based compensation and income taxes. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumption conditions.

Critical accounting policies are those that, in management's view, are most important in the portrayal of our financial condition and results of operations. Management believes there have been no material changes during the nine months ended September 30, 2014 to the critical accounting policies discussed in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of our Annual Report on Form 10-K for the year ended December 31, 2013.

## Results of Operations

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

|  | Three Months Ended |            | Nine Months Ended |            |
|--|--------------------|------------|-------------------|------------|
|  | September 30,      |            | September 30,     |            |
|  | 2014               | 2013       | 2014              | 2013       |
| Revenues                                   | \$51,013           | \$50,196   | \$153,353         | \$151,659  |
| Cost of revenues                           | 14,272             | 25,532     | 46,305            | 61,303     |
| Amortization of acquired intangible assets | 435                | 432        | 1,328             | 1,289      |
| Gross profit                               | 36,306             | 24,232     | 105,720           | 89,067     |
| Operating expenses:                        |                    |            |                   |            |
| Research and development                   | 4,423              | 3,028      | 13,138            | 10,376     |
| In-process research and development        | 527                | —          | 527               | —          |
| Sales and marketing                        | 18,649             | 18,149     | 56,545            | 55,804     |
| General and administrative                 | 10,213             | 11,443     | 33,676            | 34,018     |
| Amortization of acquired intangible assets | 742                | 741        | 2,257             | 2,255      |
| Restructuring expense                      | 20                 | 4,045      | 706               | 4,045      |
| Total operating expenses                   | 34,574             | 37,406     | 106,849           | 106,498    |
| Operating income (loss)                    | 1,732              | (13,174)   | (1,129)           | (17,431)   |
| Other income (expense):                    |                    |            |                   |            |
| Interest income                            | 2                  | 2          | 8                 | 4          |
| Interest expense                           | (3,875)            | (1,048)    | (9,310)           | (2,670)    |
| Other income (expense), net                | (928)              | 210        | (1,230)           | (840)      |
| Total other income (expense)               | (4,801)            | (836)      | (10,532)          | (3,506)    |
| Pretax net loss                            | (3,069)            | (14,010)   | (11,661)          | (20,937)   |
| Income tax (benefit) provision             | (28)               | 500        | 948               | 883        |
| Net loss                                   | \$(3,041)          | \$(14,510) | \$(12,609)        | \$(21,820) |

## Three Months Ended September 30, 2014 Compared to the Three Months Ended September 30, 2013

Revenues. Revenues were \$51.0 million for the three months ended September 30, 2014 compared to \$50.2 million for the three months ended September 30, 2013, representing an increase of \$0.8 million, or 1.6%. The increase was the result of growth in the U.S. region (\$1.1 million), offset by a decrease in the International region (\$0.3 million). U.S. revenues were \$34.8 million for the three months ended September 30, 2014 compared to \$33.7 million for the three months ended September 30, 2013, representing an increase of \$1.1 million, or 3.3%. The increase was the result of greater sales directly to hospitals (\$1.2 million), offset by a decrease in sales to stocking distributors in the U.S. (\$0.1 million).

International revenues were \$16.2 million for the three months ended September 30, 2014 compared to \$16.5 million for the three months ended September 30, 2013, representing a decrease of \$0.3 million, or 1.8%. The decrease was the result of the elimination of revenue in France as a result of the restructuring of our Scient'x operations (\$1.3 million), offset by a growth in implants and instruments (\$1.0 million). The decrease in revenue is inclusive of \$0.4 million in unfavorable exchange rate effect.

Cost of revenues. Cost of revenues was \$14.3 million for the three months ended September 30, 2014 compared to \$25.5 million for the three months ended September 30, 2013, representing a decrease of \$11.3 million, or 44.1%. The decrease was primarily the result of one-time charges in 2013 for increased inventory and instrument reserves related to the restructuring of the Scient'x organization (\$4.5 million), the obsolescence of the Puregen inventory (\$3.5 million) and the obsolescence of certain inventory related to an interbody fusion MIS product (\$1.0 million) and one-time benefits realized in 2014 for the elimination of milestone accruals related to the amendment of a license agreement (\$1.7 million), offset by one-time charges for contingent consideration associated with the 2012 Phygen

acquisition (\$0.5 million). In addition, there was a reduction in amortization expense related to the Cross Medical settlement, for which expenses concluded in 2013 (\$1.1 million), and a

reduction in depreciation expense related to instruments (\$0.7 million), offset by an increase in inventory reserves and adjustments (\$0.7 million).

Amortization of acquired intangible assets. Amortization of acquired intangible assets was \$0.4 million for both the three months ended September 30, 2014 and 2013. This expense represented amortization in the period for intangible assets associated with product related assets obtained in acquisitions.

Gross profit. Gross profit was \$36.3 million for the three months ended September 30, 2014 compared to \$24.2 million for the three months ended September 30, 2013, representing an increase of \$12.1 million, or 49.8%. The increase was due to a reduction in the cost of revenues (\$11.5 million) and an increase in sales volume (\$0.6 million).

Gross margin. Gross margin was 71.2% for the three months ended September 30, 2014 compared to 48.3% for the three months ended September 30, 2013. The increase of 22.9 percentage points was due to a reduction in non-recurring charges and benefits (20.4 percentage points), amortization expense related to the Cross Medical settlement, for which expenses concluded in 2013 (2.1 percentage points), and a reduction in depreciation expense related to instruments (1.5 percentage points), offset by an increase in inventory reserves and adjustments (0.5 percentage points), an increase in royalty and milestone expenses due to a change in product mix (0.4 percentage points) and unfavorable variation in regional and product mix (0.2 percentage points).

Gross margin for the U.S. region was 75.8% for the three months ended September 30, 2014 compared to 57.3% for the three months ended September 30, 2013. The increase of 18.5 percentage points was due to a reduction in non-recurring charges and benefits (16.8 percentage points), amortization expense related to the Cross Medical settlement, for which expenses concluded in 2013 (3.2 percentage points), and a reduction in depreciation expense related to instruments (1.7 percentage points), offset by an increase in inventory reserves and adjustments (1.2 percentage points), and unfavorable variation in pricing and product mix (1.8 percentage points) and an increase in royalty and milestone expenses due to a change in product mix (0.2 percentage points).

Gross margin for the International region was 61.3% for the three months ended September 30, 2014 compared to 29.9% for the three months ended September 30, 2013. The increase of 31.4 percentage points was due to 2013 reserves related to the restructuring of the Scient'x organization (27.5 percentage points), a favorable variation in pricing and product mix (2.6 percentage points), a reduction in instrument depreciation (1.3 percentage points), a reduction in inventory reserves and adjustments (0.6 percentage points), offset by an increase in royalty expense based on product mix (0.6 percentage points).

Research and development expense. Research and development expense was \$4.4 million for the three months ended September 30, 2014 compared to \$3.0 million for the three months ended September 30, 2013, representing an increase of \$1.4 million, or 46.1%. The increase was related to an increase in development activities.

In-process research and development expense. In-process research and development expense was \$0.5 million for the three months ended September 30, 2014 compared to \$0 million for the three months ended September 30, 2013, representing an increase of \$0.5 million. The \$0.5 million expense in 2014 relates to initial purchase payments on asset purchase agreements for which the underlying product was not technologically feasible at the time the asset was acquired.

Sales and marketing expense. Sales and marketing expense was \$18.6 million for the three months ended September 30, 2014 compared to \$18.1 million for the three months ended September 30, 2013, representing an increase of \$0.5 million, or 2.8%. The increase was primarily due to an increase in commission expense (\$0.3 million) and an increase in selling and marketing activities (\$0.8), partially offset by a reduction of expenses in the International region resulting from the restructuring of the Scient'x organization (\$0.6 million).

General and administrative expense. General and administrative expense was \$10.2 million for the three months ended September 30, 2014 compared to \$11.4 million for the three months ended September 30, 2013, representing a decrease of \$1.2 million, or 10.7%. The decrease was primarily due to the elimination of legal expenses associated with the Orthotec litigation.

Amortization of acquired intangible assets. Amortization of acquired intangible assets was \$0.7 million for both the three months ended September 30, 2014 and 2013. This expense represents amortization in the period for intangible assets associated with general business assets obtained in acquisitions.



Restructuring expense. Restructuring expense was less than \$0.1 million for the three months ended September 30, 2014 compared to \$4.0 million for the three months ended September 30, 2013. In September 2013, we announced that Scient'x had begun a process to significantly restructure its business operations in France in an effort to improve operating efficiencies and rationalize its cost structure. As of September 30, 2014 substantially all the activities associated with the restructuring are completed and most of these costs have been paid.

Interest expense, net. Interest expense, net, was \$3.9 million for the three months ended September 30, 2014 and \$1.0 million for the three months ended September 30, 2013 representing an increase of \$2.8 million, or 269.8%. The increase is primarily due to interest expense and amortization of debt discount related to the Deerfield facility (\$1.8 million), imputed

interest on the Orthotec settlement (\$0.5 million) and interest on higher levels of borrowings under the MidCap facility (\$0.5 million).

Other income (expense), net. Other income (expense) was net expense of \$0.9 million for the three months ended September 30, 2014 compared to net income of \$0.2 million for the three months ended September 30, 2013, representing an increase in expense of \$1.1 million. The increase in expense September 30, 2014 was due to unfavorable foreign currency exchange results realized in 2014 due to having U.S. dollar denominated assets and liabilities on foreign subsidiaries books (\$1.6 million), partially offset by a decrease in the fair value of common stock warrant liability \$0.5 million.

Income tax (benefit) provision. Income tax (benefit) provision was \$0.0 million for the three months ended September 30, 2014 compared to a provision of \$0.5 million for the three months ended September 30, 2013. The income tax benefit in 2014 and provision in 2013 consists primarily of state and foreign income taxes and the tax effect of changes in deferred tax liabilities associated with tax deductible goodwill.

Nine Months Ended September 30, 2014 Compared to the Nine Months Ended September 30, 2013

Revenues. Revenues were \$153.4 million for the nine months ended September 30, 2014 compared to \$151.7 million for the nine months ended September 30, 2013, representing an increase of \$1.7 million, or 1.1%. The increase was the result of growth in the U.S. region (\$2.1 million), offset by a decrease in the International region (\$0.4 million).

U.S. revenues were \$101.4 million for the nine months ended September 30, 2014 compared to \$99.2 million for the nine months ended September 30, 2013, representing an increase of \$2.1 million, or 2.1%. The increase was the result of greater sales direct to hospitals (\$4.8 million), offset by a decrease in sales to stocking distributors in the U.S. (\$2.7 million).

International revenues were \$52.0 million for the nine months ended September 30, 2014 compared to \$52.4 million for the nine months ended September 30, 2013, representing a decrease of \$0.4 million, or 0.8%. The decrease was the result of the elimination of revenue in France as a result of the restructuring (\$4.4 million), offset by growth in implants and instruments in other regions (\$4.0 million). The decrease in revenue is inclusive of \$1.1 million in unfavorable exchange rate effect.

Cost of revenues. Cost of revenues was \$46.3 million for the nine months ended September 30, 2014 compared to \$61.3 million for the nine months ended September 30, 2013, representing a decrease of \$15.0 million, or 24.5%. The decrease was primarily the result of one-time charges in 2013 for increased inventory and instrument reserves related to the restructuring of the Scient'x organization (\$4.5 million), the obsolescence of the Puregen inventory (\$3.5 million) and the obsolescence of certain inventory related to an interbody fusion MIS product (\$1.0 million) and one-time benefits realized in 2014 for the elimination of milestone accruals related to the amendment of a license agreement (\$1.7 million), offset by one-time charges for contingent consideration associated with the 2012 Phygen acquisition (\$0.5 million). In addition, there was a reduction in amortization expense related to the Cross Medical settlement, for which expenses concluded in 2013 (\$3.1 million), a reduction in depreciation expense related to instruments (\$1.3 million), and a decrease in inventory reserves and adjustments (\$0.4 million).

Amortization of acquired intangible assets. Amortization of acquired intangible assets was \$1.3 million for both the nine months ended September 30, 2014 and 2013. This expense represents amortization in the period for intangible assets associated with product related assets obtained in acquisitions.

Gross profit. Gross profit was \$105.7 million for the nine months ended September 30, 2014 compared to \$89.1 million for the nine months ended September 30, 2013, representing an increase of \$16.7 million, or 18.7%. The increase was due to a reduction in the cost of revenues (\$15.3 million) and an increase in sales volume (\$1.4 million).

Gross margin. Gross margin was 68.9% for the nine months ended September 30, 2014 compared to 58.7% for the nine months ended September 30, 2013. The increase of 10.2 percentage points was due to a reduction in non-recurring charges and benefits (6.5 percentage points), amortization expense related to the Cross Medical settlement, for which expenses concluded in 2013 (2.2 percentage points), a reduction in inventory reserves and adjustments (0.6 percentage points), and a reduction in depreciation expense related to instruments (0.9 percentage points).

Gross margin for the U.S. region was 73.2% for the nine months ended September 30, 2014 compared to 63.3% for the nine months ended September 30, 2013. The increase of 9.9 percentage points as due to a reduction in

non-recurring charges and benefits (5.3 percentage points), amortization expense related to the Cross Medical settlement, for which expenses concluded in 2013 (3.4 percentage points), favorable variation in product mix (0.4 percentage points), a reduction in depreciation expense related to instruments (0.9 percentage points), and a decrease in inventory reserves and adjustments (0.4 percentage points), offset by an increase in royalty and milestone expenses due to a change in product mix (0.5 percentage points).

Gross margin for the International region was 60.6% for the nine months ended September 30, 2014 compared to 50.0% for the nine months ended September 30, 2013. The increase of 10.6 percentage points was due to 2013 reserves related to the

restructuring of the Scient'x organization (8.7 percentage points), a reduction in instrument depreciation (1.0 percentage points), a reduction in inventory reserves and adjustments (2.0 percentage points), offset by an unfavorable variation in pricing and product mix (1.1 percentage points).

Research and development expense. Research and development expense was \$13.1 million for the nine months ended September 30, 2014 compared to \$10.4 million for the nine months ended September 30, 2013, representing an increase of \$2.8 million, or 26.6%. The increase was primarily related to the beta launch of the Arsenal pedicle screw system and increased development activity.

In-process research and development expense. In-process research and development expense was \$0.5 million for the nine months ended September 30, 2014 compared to \$0.0 million for the nine months ended September 30, 2013, representing an increase of \$0.5 million. The \$0.5 million expense in 2014 relates to initial purchase payments on asset purchase agreements for which the underlying product was not technologically feasible at the time the asset was acquired.

Sales and marketing expense. Sales and marketing expense was \$56.5 million for the nine months ended September 30, 2014 compared to \$55.8 million for the nine months ended September 30, 2013, representing an increase of \$0.7 million, or 1.3%. The increase was due to an increase in commission expense (\$1.8 million), offset by a reduction in the International region resulting from the restructuring of the Scient'x organization.

General and administrative expense. General and administrative expense was \$33.7 million for the nine months ended September 30, 2014 compared to \$34.0 million for the nine months ended September 30, 2013, representing a decrease of \$0.3 million, or 1.0%. The decrease was primarily due to the legal expenses associated with the Orthotec litigation.

Amortization of acquired intangible assets. Amortization of acquired intangible assets was \$2.3 million for the nine months ended September 30, 2014 and for the nine months ended September 30, 2013. This expense represents amortization in the period for intangible assets associated with general business assets obtained in acquisitions.

Restructuring expense. Restructuring expense was \$0.7 million for the nine months ended September 30, 2014 compared to \$4.0 million for the nine months ended September 30, 2013. In September 2013, we announced that Scient'x had begun a process to significantly restructure its business operations in France in an effort to improve operating efficiencies and rationalize its cost structure. As of September 30, 2014, substantially all the activities associated with the restructuring are completed and most of these costs have been paid.

Interest expense, net. Interest expense was \$9.3 million for the nine months ended September 30, 2014 and \$2.7 million for the nine months ended September 30, 2013 representing an increase of \$6.6 million, or 248.9%. The increase is due to interest expense and amortization of debt discount related to the Deerfield facility (\$3.9 million), imputed interest on the Orthotec settlement (\$1.1 million) and interest on higher levels of borrowings under the MidCap facility (\$1.5 million).

Other income (expense), net. Other income (expense), net was expense of \$1.2 million for the nine months ended September 30, 2014 compared to expense of \$0.8 million for the nine months ended September 30, 2013, representing an increase in expense of \$0.4 million. The increase in expense was due to unfavorable foreign currency exchange results realized in 2014 due to having U.S. dollar denominated assets and liabilities on our foreign subsidiaries books (\$0.1 million) and the change in fair value of common stock warrant liability (\$0.3 million).

Income tax (benefit) provision. Income tax (benefit) provision was a provision of \$0.9 million for the nine months ended September 30, 2014 and for the nine months ended September 30, 2013. The income tax provision in 2014 consists primarily of state and foreign income taxes and the tax effect of changes in deferred tax liabilities associated with tax deductible goodwill. The income tax provision in 2013 consists primarily of income tax provisions related to state income taxes, the tax effect of changes in deferred tax liabilities associated with tax deductible goodwill and operations in other foreign jurisdictions where we operate.

#### Non-GAAP Financial Measures

We utilize certain financial measures that are not calculated based on Generally Accepted Accounting Principles, or GAAP. Certain of these financial measures are considered "non-GAAP" financial measures within the meaning of Item 10 of Regulation S-K promulgated by the SEC. We believe that non-GAAP financial measures reflect an additional way of viewing aspects of our operations that, when viewed with the GAAP results, provide a more

complete understanding of our results of operations and the factors and trends affecting our business. These non-GAAP financial measures are also used by our management to evaluate financial results and to plan and forecast future periods. However, non-GAAP financial measures should be considered as a supplement to, and not as a substitute for, or superior to, the corresponding measures calculated in accordance with GAAP. Non-GAAP financial measures used by us may differ from the non-GAAP measures used by other companies, including our competitors.

Adjusted EBITDA represents net income (loss) excluding the effects of interest, taxes, depreciation, amortization, stock-based compensation, other income (expense) and other non-recurring income or expense items, such as litigation expenses and trial costs, in-process research and development expense, acquisition related transaction expenses and restructuring expenses. We believe that the most directly comparable GAAP financial measure to adjusted EBITDA is net income (loss). Adjusted EBITDA has limitations. Therefore, adjusted EBITDA should not be considered either in isolation or as a substitute for analysis of our results as reported under GAAP. Furthermore, adjusted EBITDA should not be considered as an alternative to operating income (loss) or net income (loss) as a measure of operating performance or to net cash provided by operating, investing or financing activities, or as a measure of our ability to meet cash needs.

The following is a reconciliation of adjusted EBITDA to the most comparable GAAP measure, net loss, for the three and nine months ended September 30, 2014 and 2013 (in thousands):

|  | Three Months Ended September |             | Nine Months Ended September |             |
|--|------------------------------|-------------|-----------------------------|-------------|
|  | 30,                          |             | 30,                         |             |
|  | 2014                         | 2013        | 2014                        | 2013        |
| Net loss                                   | \$(3,041                     | ) \$(14,510 | ) \$(12,609                 | ) \$(21,820 |
| Stock-based compensation                   | 1,502                        | 853         | 3,641                       | 2,832       |
| Depreciation                               | 2,895                        | 3,677       | 9,247                       | 10,852      |
| Amortization of intangible assets          | 379                          | 2,525       | 1,174                       | 5,568       |
| Amortization of acquired intangible assets | 1,177                        | 1,173       | 3,585                       | 3,544       |
| In-process research and development        | 527                          | —           | 527                         | —           |
| Interest expense, net                      | 3,873                        | 1,046       | 9,302                       | 2,666       |
| Income tax (benefit) provision             | (28                          | ) 500       | 948                         | 883         |
| Other income (expense), net                | 928                          | (210        | ) 1,230                     | 840         |
| Restructuring and other expense            | 20                           | 11,666      | 742                         | 12,321      |
| Litigation expenses and trial costs        | —                            | —           | 4,779                       | —           |
| Adjusted EBITDA                            | \$8,232                      | \$6,720     | \$22,566                    | \$17,686    |

#### Liquidity and Capital Resources

At September 30, 2014, our principal sources of liquidity consisted of cash of \$20.2 million and accounts receivable, net of \$40.1 million. Based on our operating plan and cash forecast, management believes that on a combined basis, such amounts will be sufficient to fund our projected operating requirements through at least September 30, 2015. We expect to fund the operating expenses from available cash, cash flow from operating activity and unused availability under the revolving credit and term loan with MidCap Financial, LLC, or MidCap.

On June 7, 2012, we entered into a credit facility, or the Credit Facility, with MidCap, which was amended and restated on August 30, 2013 to, among other things, increase the borrowing limit from \$50 million to \$73 million. The Credit Facility is due in August 2016 and consists of a revolving line of credit with a maximum borrowing base of \$40 million and a \$33 million term loan. A \$5 million delayed draw on the term loan was borrowed on April 1, 2014. The revolving line bears an interest rate equal to the London Interbank Market Rate, or LIBOR, plus 6.0% and the term loan bears an interest rate of LIBOR plus 8.0%, subject to a 9.5% floor.

The Credit Facility contains certain financial covenants which require us to maintain a certain fixed charge coverage ratio, a senior leverage ratio and a total leverage ratio in order to avoid default under the Credit Facility. We were in compliance with all of the covenants of the Credit Facility as of September 30, 2014. See "Credit Facility and Other Debt" below.

On March 15, 2014, we, Orthotec and certain other parties, including certain directors and affiliates entered into a binding term sheet to settle the pending litigation in the Orthotec, LLC vs. Surgical S.A.S. legal matter and all other litigation matters between Orthotec, LLC and us and our directors and affiliates. Pursuant to the binding term sheet, we have agreed to pay Orthotec \$49 million in cash payments. In accordance with the binding term sheet, we made payments totaling \$1.75 million in March 2014 and we made an additional \$15.75 million payment on April 10, 2014. We will pay the remaining \$31.5 million to Orthotec in 28 quarterly installments of \$1.1 million beginning in October

2014. HealthpointCapital has agreed to contribute \$5 million to the \$49 million settlement amount. In addition, a 7% simple interest rate will accrue on the unpaid portion of the remaining \$31.5 million that we owe, which we will pay in \$1.1 million quarterly payments after the \$49 million settlement amount is paid. We anticipate funding a portion of the payment obligations partially through 2016 with proceeds from the Facility Agreement described in the next paragraph.

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On March 17, 2014, we entered into a facility agreement facility agreement, ("the Facility Agreement"), with Deerfield Private Design Fund II, L.P., Deerfield Private Design International II, L.P., Deerfield Special Situations Fund, L.P., and Deerfield Special Situations International Master Fund, L.P., (collectively, "Deerfield"), pursuant to which Deerfield agreed to loan us up to \$50 million, subject to the terms and conditions set forth in the Facility Agreement. Under the terms of the Facility Agreement, we have the option, but are not required, upon certain conditions to draw the entire amount available under the Facility Agreement, at any time until January 30, 2015 provided that the initial draw be used for a portion of the payments made in connection with the Orthotec settlement described above, or the Litigation Satisfaction. Following such initial draw down, we may draw down additional amounts under the Facility Agreement up to an aggregate of \$15.0 million for working capital or general corporate purposes. We agreed to pay Deerfield, upon each disbursement of funds under the Facility Agreement, a transaction fee equal to 2.5% of the principal amount of the funds disbursed in addition to the issuance of additional warrants to purchase up to 10,000,000 shares of the Company's common stock to Deerfield. On March 20, 2014, we drew \$20 million under the Facility Agreement and received net proceeds of \$19.5 million to fund the 2014 Orthotec settlement payment obligations.

Based on our current operating plan, we believe that we will be in compliance with our financial covenants under the Credit Facility and the Facility Agreement for the foreseeable future. However, there is no assurance that we will be able to do so. If we are not able to achieve our planned revenue or if we incur costs in excess of our forecasts, we may be required to substantially reduce discretionary spending, and we could be in default of the Credit Facility and the Facility Agreement. Upon the occurrence of an event of default which is not waived by MidCap or Deerfield, they could declare the amounts outstanding under the Credit Facility and the Facility Agreement immediately due and payable and refuse to extend further credit. If MidCap or Deerfield were to accelerate the repayment of borrowings under the Credit Facility and the Facility Agreement, we may not have sufficient cash on hand to repay the amounts due under the Credit Facility and the Facility Agreement and would have to seek to amend the terms of the Credit Facility and the Facility Agreement or seek alternative financing. There can be no assurance that in the event of a default, a waiver could be obtained from MidCap or Deerfield, that the Credit Facility and the Facility Agreement could be successfully renegotiated or that we could modify our operations to maintain liquidity. If we are forced to seek additional financing, which may include additional debt and/or equity financing or funding through other third party agreements, there can be no assurance that additional financing will be available on favorable terms or available at all. Furthermore, any equity financing may result in dilution to existing stockholders and any debt financing may include restrictive covenants.

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

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



resulting from a changing regulatory environment.

A substantial portion of our available cash funds is held in business accounts with reputable financial institutions. At times, however, our deposits, may exceed federally insured limits and thus we may face losses in the event of insolvency of any of the financial institutions where our funds are deposited. We did not hold any marketable securities as of September 30, 2014.

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### Operating Activities

We used net cash of \$20.3 million from operating activities for the nine months ended September 30, 2014. During this period, net cash used in operating activities primarily consisted of a net loss of \$12.6 million and working capital and other assets of \$35.8 million, which were offset by \$28.1 million of non-cash costs including amortization, depreciation, deferred income taxes, stock-based compensation, provision for excess and obsolete inventory, and interest expense related to amortization of debt discount and issue costs. Working capital and other assets of \$35.8 million consisted of increases in restricted cash of \$2.0 million, inventories of \$3.1 million and in other assets of \$0.2 million and decreases in accrued expenses and other liabilities of \$34.7 million and accounts payable of \$0.3 million, partially offset by decreases in accounts receivable of \$0.4 million and prepaid expenses and other current assets of \$4.1 million. The increase in restricted cash was funded by proceeds of \$19.5 million from notes payable included in financing activities and was reduced by payments of \$17.5 million for the Orthotec settlement, with a corresponding decrease in accrued liabilities. Accrued expenses related to the Scient'x restructuring decreased by \$7.8 million primarily due to the payment of employee severance and related payroll taxes.

### Investing Activities

We used cash of \$7.5 million, net of accounts payable, in investing activities for the nine months ended September 30, 2014, including \$7.8 million for the purchase of surgical instruments, offset by a \$0.3 million cash receipt for the sale of assets.

### Financing Activities

Financing activities provided net cash of \$27.1 million for the nine months ended September 30, 2014. We drew \$20 million under the Deerfield facility and received cash proceeds of \$19.5 million, net of a transaction fee of \$0.5 million and drew \$5 million on the MidCap term loan. Borrowings net of payments under the Amended Credit Facility revolving line of credit totaled \$7.0 million in the nine months ended September 30, 2014. We made principal payments on notes payable and capital leases totaling \$4.4 million in the nine months ended September 30, 2014.

#### Amended Credit Facility and Other Debt

On August 30, 2013, we entered into an Amended and Restated Credit, Security and Guaranty Agreement with MidCap to, among other things, increase the borrowing limit from \$50 million to \$73 million. We also extended the maturity to August 2016. The Amended Credit Facility consists of a \$33 million term loan, \$28 million of which was drawn at closing and a \$5 million delayed draw that was drawn in April 2014, and a revolving line of credit with a maximum borrowing base of \$40 million. We used the term loan proceeds of \$28 million to repay a portion of the outstanding balance on the prior revolving line of credit. The \$5 million delayed draw was borrowed on April 1, 2014. In addition to monthly payments of interest, monthly repayments of \$0.3 million of the principal for the term loan were made beginning in October 2013, increasing to \$0.5 million beginning in October 2014, and are due through maturity, with the remaining principal due upon maturity.

The Amended Credit Facility includes traditional lending and reporting covenants which among other things requires us to maintain a fixed charge coverage ratio and a senior leverage ratio. The Credit Facility also includes several potential events of default, such as payment default and insolvency conditions, which could cause interest to be charged at a rate which is up to five percentage points above the rate effective immediately before the event of default or result in MidCap's right to declare all outstanding obligation immediately due and payable. We were in compliance with all of the covenants of the Amended Credit Facility as of September 30, 2014.

On March 17, 2014, we entered into a First Amendment to Amended and Restated Credit, Security and Guaranty Agreement, or the First Amendment, with MidCap as Administrative Agent and lender and other lenders from time to time a party thereto, or together with MidCap, the Lenders. The First Amendment permits, among other things, our execution of, and borrowing of loans, under the Facility Agreement and Alphatec Spine's granting of liens as security therefore, and the consummation of a Litigation Satisfaction and the completion of certain conditions. The First Amendment also added a total leverage ratio financial covenant to the Amended Credit Facility.

On March 20, 2014, we drew \$20 million under the Facility Agreement with Deerfield and received net proceeds of \$19.5 million to fund the portion of the Orthotec settlement payment obligations that are due in 2014. The amounts borrowed under the Facility Agreement are due in three equal annual payments beginning March 20, 2017.

We have various capital lease arrangements. The leases bear interest at rates ranging from 6.6% to 9.6%, are generally due in monthly principal and interest installments, are collateralized by the related equipment, and have various maturity dates through June 2017. As of September 30, 2014, the balance of these capital leases, net of interest totaled \$1.5 million.

## Contractual obligations and commercial commitments

Total contractual obligations and commercial commitments as of September 30, 2014 are summarized in the following table (in thousands):

|  | Payment Due by Year |                    |                 |                 |                 |                 |                 |
|--|---------------------|--------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
|  | Total               | 2014<br>(3 months) | 2015            | 2016            | 2017            | 2018            | Thereafter      |
| Amended Credit Facility with MidCap    | \$61,828            | \$1,402            | \$5,609         | \$54,817        | \$—             | \$—             | \$—             |
| Credit Facility with Deerfield         | 20,000              | —                  | —               | —               | 6,667           | 6,667           | 6,666           |
| Interest expense                       | 17,726              | 1,970              | 6,808           | 5,011           | 1,750           | 1,750           | 437             |
| Notes payable for software licenses    | 308                 | 73                 | 158             | 77              | —               | —               | —               |
| Note payable for insurance premiums    | 1,645               | 543                | 1,102           | —               | —               | —               | —               |
| Capital lease obligations              | 1,649               | 181                | 662             | 623             | 183             | —               | —               |
| Operating lease obligations            | 6,381               | 877                | 3,228           | 1,827           | 377             | 68              | 4               |
| Litigation settlement obligations      | 44,333              | 2,100              | 7,400           | 4,400           | 4,400           | 4,400           | 21,633          |
| Minimum purchase commitments           | 33,770              | 4,520              | 5,850           | 5,850           | 5,850           | 5,850           | 5,850           |
| Guaranteed minimum royalty obligations | 12,554              | 1,858              | 2,496           | 2,546           | 2,218           | 2,218           | 1,218           |
| New product development milestones (1) | 200                 | —                  | —               | 200             | —               | —               | —               |
| <b>Total</b>                           | <b>\$200,394</b>    | <b>\$13,524</b>    | <b>\$33,313</b> | <b>\$75,351</b> | <b>\$21,445</b> | <b>\$20,953</b> | <b>\$35,808</b> |

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

## Stock-based Compensation

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

|  | Three Months Ended |              | Nine Months Ended September |                |
|--|--------------------|--------------|-----------------------------|----------------|
|  | September 30,      |              | 30,                         |                |
|  | 2014               | 2013         | 2014                        | 2013           |
| Cost of revenues                               | \$94               | \$58         | \$240                       | \$167          |
| Research and development                       | 699                | 48           | 1,809                       | 136            |
| Sales and marketing                            | 141                | 125          | 351                         | 335            |
| General and administrative                     | 568                | 622          | 1,241                       | 2,194          |
| <b>Total</b>                                   | <b>\$1,502</b>     | <b>\$853</b> | <b>\$3,641</b>              | <b>\$2,832</b> |
| Effect on basic and diluted net loss per share | \$(0.01)           | \$(0.01)     | \$(0.02)                    | \$(0.03)       |

## Recent Accounting Pronouncements

In March 2013, the Financial Accounting Standards Board, or FASB, issued guidance on a parent company's accounting for the cumulative translation adjustment upon derecognition of a subsidiary or group of assets within a foreign entity. This new guidance requires that the parent release any related cumulative translation adjustment into net income only if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity

in which the subsidiary or group of assets had resided. The amendments became effective for us on January 1, 2014. We adopted this guidance and the adoption did not have any impact on our financial statements.

In April 2014, the FASB issued new guidance related to reporting discontinued operations. This new standard raises the threshold for a disposal to qualify as a discontinued operation and requires new disclosures of both discontinued operations and certain other disposals that do not meet the definition of a discontinued operation. The new standard is effective for fiscal years beginning on or after December 15, 2014. We are evaluating the impact, if any, of adopting this new accounting standard on our financial statements.

In May 2014, the FASB issued new accounting guidance related to revenue recognition. This new standard will replace all current U.S. GAAP guidance on this topic and eliminate all industry-specific guidance. The new revenue recognition standard provides a unified model to determine when and how revenue is recognized. The core principle is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This guidance will be effective for us beginning January 1, 2017 and can be applied either retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. We are evaluating the impact of adopting this new accounting standard on our financial statements.

In August 2014, the FASB issued guidance related to disclosures of uncertainties about an entity's ability to continue as a going concern. The guidance requires management to evaluate whether there are conditions and events that raise substantial doubt about the entity's ability to continue as a going concern within one year after the financial statements are issued. Management will be required to make this evaluation for both annual and interim reporting periods and will have to make certain disclosures if it concludes that substantial doubt exists or when its plans alleviate substantial doubt about the entity's ability to continue as a going concern. Substantial doubt exists when relevant conditions and events, considered in the aggregate, indicate that it is probable that the entity will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued. The guidance is effective for annual periods ending after December 15, 2016 and for interim reporting periods starting in the first quarter 2017, with early adoption permitted. We are currently evaluating the impact of this guidance and expect to adopt the standard for the annual reporting period ended December 31, 2016.

#### Forward Looking Statements

This Quarterly Report on Form 10-Q incorporates a number of forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, or the Exchange Act, including statements regarding:

- our estimates regarding anticipated operating losses, future revenue, expenses, capital requirements, uses and sources of cash and liquidity, including our anticipated revenue growth and cost savings;
- our ability to market, improve, grow, commercialize and achieve market acceptance of any of our products or any product candidates that we are developing or may develop in the future;
- the effect of our strategy to streamline our organization and lower our costs, including the effect of the restructuring of our French operations, on the financial condition and operations of our business, and the timing of such effects;
- our beliefs about the attractiveness of the features and benefits of our products;
- our ability to successfully integrate, and realize benefits from acquisitions;
- our ability to successfully achieve and maintain regulatory clearance or approval for our products in applicable jurisdictions and in a timely manner;
- the effect of any existing or future federal, state or international regulations on our ability to effectively conduct our business;
- our estimates of market sizes and anticipated uses of our products, including the market size of the aging spine market and our ability to successfully penetrate such market;
- our business strategy and our underlying assumptions about market data, demographic trends, reimbursement trends, pricing trends, and trends relating to customer collections;
- our ability to achieve profitability, and the potential need to raise additional funding;
- our ability to maintain an adequate sales network for our products, including to attract and retain independent distributors;
- our ability to enhance our U.S. and international sales networks and product penetration;
- our ability to attract and retain a qualified management team, as well as other qualified personnel and advisors;



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

our beliefs with respect to the attainment of sales milestones, development milestones, and product design and functionality testing requirements;

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

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

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

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

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

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

potential liability resulting from litigation and its potential effects on our results of operations, cash flows and financial position;

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

our beliefs about the usefulness of the non-GAAP financial measures included in this Quarterly Report on Form 10-Q;

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

our beliefs with respect to our critical accounting policies and the reasonableness of our estimates and assumptions;

our expectations about the technological and commercial feasibility of our acquired in-process research and development assets and our plans in the event any such IPR&D assets are not technologically or commercially feasible; and

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

Any or all of our forward-looking statements in this Quarterly Report on Form 10-Q may turn out to be wrong. They can be affected by inaccurate assumptions by known or unknown risks and uncertainties. Many factors mentioned in our discussion in this Quarterly Report on Form 10-Q will be important in determining future results. Consequently, no forward-looking statement can be guaranteed. Actual future results may vary materially from expected results. We also provide a cautionary discussion of risks and uncertainties under "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2013 and any updates to those risk factors filed from time to time in our subsequent periodic and current reports filed with the SEC. These are factors that we think could cause our actual results to differ materially from expected results. Other factors besides those listed there could also adversely affect us.

Without limiting the foregoing, the words "believe," "anticipate," "plan," "expect," "estimate," "may," "will," "should," "could," "seek," "intend," "continue," "project," and similar expressions are intended to identify forward-looking statements. There are a number of factors and uncertainties that could cause actual events or results to differ materially from those indicated by such forward-looking statements, many of which are beyond our control, including the factors set forth under "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2013. In addition, the forward-looking statements contained herein represent our estimate only as of the date of this filing and should not be relied upon as representing our estimate as of any subsequent date. While we may elect to update these forward-looking statements at some point in the future, we specifically disclaim any obligation to do so to reflect actual results, changes in assumptions or changes in other factors affecting such forward-looking statements.



Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk

Our borrowings under our Amended Credit Facility expose us to market risk related to changes in interest rates. As of September 30, 2014, our outstanding floating rate indebtedness totaled \$61.8 million. The primary base interest rate is the LIBOR rate. Assuming the outstanding balance on our floating rate indebtedness remains constant over a year, a 100 basis point increase in the interest rate would decrease pre-tax income and cash flow by approximately \$0.6 million. Other outstanding debt consists of fixed rate instruments, including notes payable and capital leases.

Foreign Currency Risk

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

Commodity Price Risk

We purchase raw materials that are processed from commodities, such as titanium and stainless steel. These purchases expose us to fluctuations in commodity prices. Given the historical volatility of certain commodity prices, this exposure can impact our product costs. However, because our raw material prices comprise a small portion of our cost of revenues, we have not experienced any material impact on our results of operations from changes in commodity prices. A 10% change in commodity prices would not have had a material impact on our results of operations for the nine months ended September 30, 2014.

Equity Price Risk

In connection with the Facility Agreement with Deerfield, we have issued warrants to purchase 10,250,000 shares of our common stock. We recorded the warrant liability at fair value and adjust the carrying value of these common stock warrants to their estimated fair value at each reporting date with the increases or decreases in the fair value of such warrants at each reporting date recorded as other income (expense) in our consolidated statement of operations. A 10 percent increase in our stock price from its September 30, 2014 closing price of \$1.70 per share would increase the fair value of the warrant liability by approximately \$1.4 million with a corresponding charge to our income statement.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed by us in our reports that we file or submit pursuant to the Securities Exchange Act of 1934, as amended, or the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's, or SEC's, rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, we carried out an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms, and is accumulated and communicated to our management, including our Chief Executive Officer and Chief



Financial Officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting, identified in connection with the evaluation of such internal control that occurred during the quarter ended September 30, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

#### Litigation

We previously reported that on March 15, 2014, we entered into a binding term sheet, or the Binding Term Sheet, to resolve the Orthotec, LLC v. Surgiview, S.A.S, et al. matter in the Superior Court of California, Los Angeles County and related litigation matters, or the Orthotec Settlement. Both the Orthotec litigation matter and the Orthotec Settlement have been previously reported. Pursuant to the terms contained in the Binding Term Sheet, we agreed to pay Orthotec, LLC \$49 million in cash, including initial cash payments totaling \$1.75 million, which the Company previously paid in March 2014, and an additional lump sum payment of \$15.75 million, which the Company previously paid in June 2014. The Company agreed to pay the remaining \$31.5 million in 28 quarterly installments of \$1.1 million and then one additional quarterly installment of \$700,000, commencing October 1, 2014. We have the right to prepay the amounts due without penalty. In addition, the unpaid balance of the amounts due will accrue interest at the rate of 7% per year beginning May 15, 2014 until the amounts due are paid in full. The accrued but unpaid interest will be paid in quarterly installments of \$1.1 million (or the full amount of the accrued but unpaid interest if less than \$1.1 million) following the full payment of the \$31.5 million in quarterly installments described above. No interest will accrue on the accrued interest. The Binding Term Sheet provided for mutual releases of all claims in the Orthotec, LLC v. Surgiview, S.A.S, et al. matter in the Superior Court of California, Los Angeles County and all other related litigation matters involving us and our directors and affiliates.

On September 26, 2014, we entered into a Settlement and Release Agreement, dated as of August 13, 2014, by and among us and our direct and indirect subsidiaries and affiliates, including Alphatec Spine, Inc. and its direct and indirect subsidiaries, Alphatec Holdings International C.V. and its direct and indirect subsidiaries and affiliates, including Scient'x S.A.S. and Surgiview S.A.S.; HealthpointCapital, LLC, HealthpointCapital Partners, L.P., HealthpointCapital Partners II, L.P., John H. Foster and Mortimer Berkowitz III; and Orthotec, LLC and Patrick Bertranou, or the Settlement Agreement. The Settlement Agreement contains substantially the same business terms as the Binding Term Sheet set forth above, and supersedes the Binding Term Sheet.

On August 10, 2010, a purported securities class action complaint was filed in the United States District Court for the Southern District of California on behalf of all persons who purchased our common stock between December 19, 2009 and August 5, 2010 against us and certain of our directors and officers alleging violations of the Exchange Act and Rule 10b-5 promulgated thereunder. On February 17, 2011, an amended complaint was filed against us and certain of our directors and officers adding alleged violations of the Securities Act. HealthpointCapital, Jefferies & Company, Inc., Canaccord Adams, Inc., Cowen and Company, Inc., and Lazard Capital Markets LLC are also defendants in this action. The complaint alleges that the defendants made false or misleading statements and failed to disclose material facts about our business, financial condition, operations and prospects, particularly relating to the Scient'x transaction and our financial guidance following the closing of the acquisition. The complaint seeks unspecified monetary damages, attorneys' fees, and other unspecified relief. We filed a motion to dismiss the amended complaint on April 18, 2011. The district court granted the motion to dismiss with leave to amend on March 22, 2012. On April 19, 2012, the lead plaintiff filed a Second Amended Complaint alleging violations of Sections 10(b) and 20(a) of the Exchange Act and violations of Section 11, 12(a)(2), and 15 of the Securities Act against the same named defendants. On May 3, 2012, we filed a motion to dismiss the Second Amended Complaint. The district court granted that motion without leave to amend and entered final judgment in our favor on March 28, 2013. On April 17, 2013, the lead plaintiff filed a notice of appeal to the United States Court of Appeals for the Ninth Circuit. The appeal has been fully briefed. We believe that the claims are without merit and we intend to vigorously defend ourselves against this complaint. However, the outcome of the litigation cannot be predicted at this time and any outcome that is adverse to us, regardless of who the defendant is, could have a significant adverse effect on our financial condition and results of operations.

On August 25, 2010, an alleged shareholder of ours filed a derivative lawsuit in the Superior Court of California, San Diego County, purporting to assert claims on behalf of us against all of our directors and certain of our officers and HealthpointCapital. Following the filing of this complaint, similar complaints were filed in the same court and in the

U.S. District Court for the Southern District of California against the same defendants containing similar allegations. The complaint filed in federal court was dismissed by the plaintiff without prejudice in July 2011. The state court complaints were consolidated into a single action and we were named as a nominal defendant in the consolidated action. Each complaint alleges that our directors and certain of our officers breached their fiduciary duties to us related to the Scient'x transaction, and by making allegedly false statements that led to unjust enrichment of HealthpointCapital and certain of our directors. The complaints seek unspecified monetary damages and an order directing us to adopt certain measures purportedly designed to improve our corporate governance and internal procedures. On January 8, 2014, the parties reached an agreement in principle

to resolve all claims in exchange for corporate governance reforms and payment of attorneys' fees in the amount of \$5.25 million, to be paid by our and HeathpointCapital's respective insurance carriers. The final settlement was approved in August 2014.

At September 30, 2014, the probable outcome of any of the aforementioned litigation matters that have not reached a settlement cannot be determined nor can we estimate a range of potential loss. Accordingly, in accordance with the authoritative guidance on the evaluation of contingencies, we have not recorded an accrual related to any litigation matters that have not reached a settlement. We are and may become involved in various other legal proceedings arising from our business activities. While management does not believe the ultimate disposition of the above matters that have not yet been settled will have a material adverse impact on our consolidated results of operations, cash flows or financial position, litigation is inherently unpredictable, and depending on the nature and timing of these proceedings, an unfavorable resolution could materially affect our future consolidated results of operations, cash flows or financial position in a particular period.

Item 1A. Risk Factors

There have been no material changes to the risk factors described under Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2013.

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

Unregistered Sales of Equity Securities

In July 2014, we entered into an asset purchase and product development services agreement with an entity that designs and develops medical devices. In connection with this agreement we issued 72,992 unregistered shares of our common stock, par value \$0.001 per share, or Stock Consideration, to the third party, which also is an accredited investor. We did not receive any cash proceeds from the issuance of the Stock Consideration. The Stock Consideration was issued in reliance upon an exemption from registration under the federal securities laws pursuant to Section 4(a)(2) of the Securities Act and/or Rule 506 of Regulation D promulgated under the Securities Act, for the issuance of securities in transactions by an issuer not involving a public offering. We do not have an obligation, nor does it anticipate, registering the Stock Consideration for resale on a registration statement pursuant to the Securities Act.

Issuer Purchases of Equity Securities

Under the terms of our Amended and Restated 2005 Employee, Director and Consultant Stock Plan, or the 2005 Plan, we may award shares of restricted stock to our employees, directors and consultants. These shares of restricted stock are subject to a lapsing right of repurchase by us. We may exercise this right of repurchase in the event that a restricted stock recipient's employment, directorship or consulting relationship with us terminates prior to the end of the vesting period. If we exercise this right, we are required to repay the purchase price paid by or on behalf of the recipient for the repurchased restricted shares. Repurchased shares are returned to the 2005 Plan and are available for future awards under the terms of the 2005 Plan. No shares were repurchased during the three months ended September 30, 2014.

| Period                                       | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as part of Publicly Announced Plans or Programs | Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs |
|--|----------------------------------|------------------------------|--|--|
| July 1, 2014 through July 31, 2014           | —                                | \$—                          | —  | —  |
| August 1, 2014 through August 31, 2014       | —                                | \$—                          | —  | —  |
| September 1, 2014 through September 30, 2014 | —                                | \$—                          | —  | —  |



Item 6. Exhibits

Exhibit Number Exhibit Description

10.1\* Amendment to the Alphatec Holdings, Inc. Amended and Restated 2005 Employee, Director and Consultant Stock Plan.

10.2\* Form of Performance-Based Restricted Unit Agreement issued under the Amended and Restated 2005 Employee, Director and Consultant Stock Plan, as amended.

10.3 Settlement and Release Agreement, dated as of August 13, 2014, by and among Alphatec Holdings, Inc. and its direct and indirect subsidiaries and affiliates, including Alphatec Spine, Inc. and its direct and indirect subsidiaries and affiliates, and Alphatec Holdings International C.V. and its direct and indirect subsidiaries and affiliates, including Scient'x S.A.S. and Surgiview S.A.S.; HealthpointCapital, LLC, HealthpointCapital Partners, L.P., HealthpointCapital Partners II, L.P., John H. Foster and Mortimer Berkowitz III; and Orthotec, LLC and Patrick Bertranou.

10.4† Third Amendment to the Exclusive License Agreement dated August 1, 2014 between Alphatec Spine, Inc. and Stout Medical Group, L.P.

31.1 Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32 Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101 The following materials from the Alphatec Holdings, Inc. Quarterly Report on Form 10-Q for the quarter ended September 30, 2014, formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Balance Sheets (Unaudited) as of September 30, 2014 and December 31, 2013, (ii) Condensed Consolidated Statements of Operations (Unaudited) for the three and nine months ended September 30, 2014 and 2013, (iii) Condensed Consolidated Statements of Comprehensive Loss (Unaudited) for the three and nine months ended September 30, 2014 and 2013, (iv) Condensed Consolidated Statements of Cash Flows (Unaudited) for the nine months ended September 30, 2014 and 2013, and (v) Notes to Condensed Consolidated Financial Statements (Unaudited).

\*Management contract or compensatory plan or arrangement.

† Confidential treatment has been requested from the Securities and Exchange Commission as to certain portions of this document.



SIGNATURES

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

ALPHATEC HOLDINGS, INC.

By: /s/ James M. Corbett  
James M. Corbett  
President and Chief Executive Officer  
(principal executive officer)

By: /s/ Michael O'Neill  
Michael O'Neill  
Chief Financial Officer, Vice President and Treasurer  
(principal financial officer and principal accounting officer)

Date: October 30, 2014

Exhibit Index

| Exhibit Number | Exhibit Description   |
|----------------|---|
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