Emdeon Inc.
Form 10-Q
May 13, 2014
**Table of Contents**

# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, D.C. 20549**

# FORM 10-Q

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)**

**OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended March 31, 2014**

**Commission file number 333-182786**

# EMDEON INC.

**(Exact Name of Registrant as Specified in its Charter)**

| **Delaware** | **20-5799664** |
|---|---|
| **(State or Other Jurisdiction of Incorporation or Organization)** | **(I.R.S. Employer Identification No.)** |
| **3055 Lebanon Pike, Suite 1000** | |
| **Nashville, TN** | **37214** |
| **(Address of Principal Executive Offices)** | **(Zip Code)** |

**(615) 932-3000**

**(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 þ*

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 þ No ¨

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

Large accelerated filer ¨ Accelerated filer ¨

Non-accelerated filer þ (Do not check if a smaller 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 þ

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date:

| Class | Outstanding as of May 13, 2014 |
|---|---|
| **Common Stock, $0.01 par value** | **100** |

* The registrant is a voluntary filer of certain reports required to be filed by companies under Section 13 or 15(d) of the Securities and Exchange Act of 1934 and has filed all reports that would have been required to have been filed by the registrant during the preceding 12 months had it been subject to such filing requirements during the entirety of such period.

Table of Contents

**Emdeon Inc.**

**Table of Contents**

Table of Contents

**PART I. FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

Table of Contents

**Emdeon Inc.**

**Condensed Consolidated Balance Sheets**

**(unaudited and amounts in thousands, except share and per share amounts)**

| | March 31, 2014 | December 31, 2013 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 76,899 | $ 76,538 |
| Accounts receivable, net of allowance for doubtful accounts of $4,011 and $3,856 at March 31, 2014 and December 31, 2013, respectively | 215,198 | 214,247 |
| Deferred income tax assets | 14,371 | 6,317 |
| Prepaid expenses and other current assets | 29,635 | 27,019 |
| Total current assets | 336,103 | 324,121 |
| Property and equipment, net | 254,494 | 269,470 |
| Goodwill | 1,508,759 | 1,502,434 |
| Intangible assets, net | 1,610,658 | 1,632,688 |
| Other assets, net | 19,855 | 19,169 |
| Total assets | $ 3,729,869 | $ 3,747,882 |
| **LIABILITIES AND EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 6,889 | $ 8,367 |
| Accrued expenses | 135,578 | 131,149 |
| Deferred revenues | 10,416 | 10,881 |
| Current portion of long-term debt | 18,972 | 31,330 |
| Total current liabilities | 171,855 | 181,727 |
| Long-term debt, excluding current portion | 2,001,956 | 1,999,026 |
| Deferred income tax liabilities | 422,659 | 436,263 |
| Tax receivable agreement obligations to related parties | 150,419 | 150,496 |
| Other long-term liabilities | 13,751 | 11,824 |
| Commitments and contingencies | | |
| Equity: | | |
| Common stock (par value, $.01), 100 shares authorized and outstanding at March 31, 2014 and December 31, 2013, respectively | | |
| Additional paid-in capital | 1,143,244 | 1,139,375 |
| Accumulated other comprehensive income (loss) | (1,540) | (1,343) |
| Accumulated deficit | (172,475) | (169,486) |
| Total equity | 969,229 | 968,546 |
| Total liabilities and equity | $ 3,729,869 | $ 3,747,882 |

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

**Emdeon Inc.**

**Condensed Consolidated Statements of Operations**

**(unaudited and amounts in thousands)**

| | Three Months Ended March 31, 2014 | Three Months Ended March 31, 2013 |
|---|---|---|
| Revenue | $ 319,207 | $ 299,359 |
| Costs and expenses: | | |
| Cost of operations (exclusive of depreciation and amortization below) | 194,133 | 183,424 |
| Development and engineering | 9,236 | 7,698 |
| Sales, marketing, general and administrative | 55,184 | 38,675 |
| Depreciation and amortization | 46,463 | 46,815 |
| Accretion | (77) | 4,140 |
| Operating income | 14,268 | 18,607 |
| Interest expense, net | 36,563 | 41,415 |
| Contingent consideration | 1,960 | |
| Income (loss) before income tax provision (benefit) | (24,255) | (22,808) |
| Income tax provision (benefit) | (21,266) | (9,357) |
| Net income (loss) | $ (2,989) | $ (13,451) |

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

**Emdeon Inc.**

**Condensed Consolidated Statements of Comprehensive Income (Loss)**

**(unaudited and amounts in thousands)**

| | Three Months Ended March 31, 2014 | Three Months Ended March 31, 2013 |
|---|---|---|
| Net income (loss) | $ (2,989) | $ (13,451) |
| Other comprehensive income (loss): | | |
| Changes in fair value of interest rate swap, net of taxes | (124) | 428 |
| Foreign currency translation adjustment | (73) | (35) |
| Other comprehensive income (loss): | (197) | 393 |
| Total comprehensive income (loss) | $ (3,186) | $ (13,058) |

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

**Emdeon Inc.**

**Condensed Consolidated Statements of Equity**

**(unaudited and amounts in thousands, except share amounts)**

| | Common Stock | | Additional Paid-in | Retained Earnings | Accumulated Other Comprehensive Income | Total |
|---|---|---|---|---|---|---|
| | Shares | Amount | Capital | (Deficit) | (Loss) | Equity |
| **Balance at January 1, 2013** | 100 | $ | $ 1,130,968 | $ (95,028) | $ (3,789) | $ 1,032,151 |
| Equity compensation expense | | | 1,775 | | | 1,775 |
| Net income (loss) | | | | (13,451) | | (13,451) |
| Foreign currency translation adjustment | | | | | (35) | (35) |
| Change in fair value of interest rate swap, net of taxes | | | | | 428 | 428 |
| **Balance at March 31, 2013** | 100 | $ | $ 1,132,743 | $ (108,479) | $ (3,396) | $ 1,020,868 |
| **Balance at January 1, 2014** | 100 | $ | $ 1,139,375 | $ (169,486) | $ (1,343) | $ 968,546 |
| Equity compensation expense | | | 1,892 | | | 1,892 |
| Capital contribution from Parent | | | 1,977 | | | 1,977 |
| Net income (loss) | | | | (2,989) | | (2,989) |
| Foreign currency translation adjustment | | | | | (73) | (73) |
| Change in fair value of interest rate swap, net of taxes | | | | | (124) | (124) |
| **Balance at March 31, 2014** | 100 | $ | $ 1,143,244 | $ (172,475) | $ (1,540) | $ 969,229 |

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

**Emdeon Inc.**

**Condensed Consolidated Statements of Cash Flows**

**(unaudited and amounts in thousands)**

| | Three Months Ended March 31, 2014 | Three Months Ended March 31, 2013 |
|---|---|---|
| **Operating activities** | | |
| Net income (loss) | $ (2,989) | $ (13,451) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Depreciation and amortization | 46,463 | 46,815 |
| Accretion | (77) | 4,140 |
| Equity compensation | 1,892 | 1,775 |
| Deferred income tax expense (benefit) | (22,132) | (9,917) |
| Amortization of debt discount and issuance costs | 1,909 | 2,601 |
| Contingent consideration | 1,960 | |
| Impairment of property and equipment | 3,067 | |
| Other | | (34) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (950) | (16,783) |
| Prepaid expenses and other | (4,279) | (971) |
| Accounts payable | (984) | 6,922 |
| Accrued expenses, deferred revenue and other liabilities | 2,787 | 17,817 |
| Tax receivable agreement obligations to related parties | | (103) |
| Net cash provided by (used in) operating activities | 26,667 | 38,811 |
| **Investing activities** | | |
| Purchases of property and equipment | (14,511) | (13,551) |
| Payments for acquisitions, net of cash acquired | (779) | |
| Net cash provided by (used in) investing activities | (15,290) | (13,551) |
| **Financing activities** | | |
| Debt principal payments | (7,669) | (3,252) |
| Repayment of deferred financing arrangements | (3,447) | |
| Capital contribution from Parent | 1,977 | |
| Other | (1,877) | (450) |
| Net cash provided by (used in) financing activities | (11,016) | (3,702) |
| Net increase (decrease) in cash and cash equivalents | 361 | 21,558 |
| Cash and cash equivalents at beginning of period | 76,538 | 31,763 |
| Cash and cash equivalents at end of period | $ 76,899 | $ 53,321 |

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

**Emdeon Inc.**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited and amounts in thousands, except share and per share amounts)**

**1. Nature of Business and Organization**

***Nature of Business***

Emdeon Inc. (the Company ), through its subsidiaries, is a provider of revenue and payment cycle management and clinical information exchange solutions, connecting payers, providers, pharmacies and patients of the United States healthcare system. The Company s product and service offerings integrate and automate key business and administrative functions for healthcare payers, providers and pharmacies throughout the patient encounter, including pre-care patient eligibility and benefits verification and enrollment, clinical information exchange, claims management and adjudication, payment integrity, payment distribution, payment posting and denial management and patient billing and payment processing.

***Organization***

The Company was formed as a Delaware limited liability company in September 2006 and converted into a Delaware corporation in September 2008 in anticipation of the Company s August 2009 initial public offering (the IPO ).

On November 2, 2011, pursuant to an Agreement and Plan of Merger among the Company, Beagle Parent Corp. ( Parent ) and Beagle Acquisition Corp. ( Merger Sub ), Merger Sub merged with and into the Company with the Company surviving the merger (the Merger ). Subsequent to the Merger, the Company became an indirect wholly-owned subsidiary of Parent, which is controlled by affiliates of The Blackstone Group L.P. ( Blackstone ).

**2. Basis of Presentation**

***Principles of Consolidation***

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles ( GAAP ) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X of the Securities and Exchange Commission ( SEC ) Guidelines, Rules and Regulations ( Regulation S-X ) and, in the opinion of management, reflect all normal recurring adjustments necessary for a fair presentation of results for the unaudited interim periods presented. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted. The results of operations for the interim period are not necessarily indicative of the results to be obtained for the full fiscal year. All material intercompany accounts and transactions have been eliminated in the unaudited condensed consolidated financial statements.

***Reclassifications***

Certain reclassifications have been made to the prior period financial statements to conform to the current period presentation. The Company changed the classification of rebate payments to its channel partners from cost of operations to a reduction of revenue to the extent that such rebate payments for any given channel partner were less than or equal to revenue otherwise earned from the respective channel partner. To conform to the current period presentation, rebate payments to channel partners resulted in a reduction of revenue of $6,343 for the three months ended March 31, 2013.

***Accounting Estimates***

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. The Company bases its estimates on historical experience, current business factors and various other assumptions that the Company believes are necessary to consider in order to form a basis for making judgments about the carrying values of assets and liabilities, the

9

Table of Contents

**Emdeon Inc.**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited and amounts in thousands, except share and per share amounts)**

recorded amounts of revenue and expenses and disclosure of contingent assets and liabilities. The Company is subject to uncertainties such as the impact of future events, economic, environmental and political factors and changes in the Company s business environment; therefore, actual results could differ materially from these estimates. Accordingly, the accounting estimates used in the preparation of the Company s financial statements will change as new events occur, as more experience is acquired, as additional information is obtained and as the Company s operating environment changes. Changes in estimates are made when circumstances warrant. Such changes in estimates and refinements in estimation methodologies are reflected in the reported results of operations; and if material, the effects of changes in estimates are disclosed in the notes to the consolidated financial statements. Estimates and assumptions by management affect: the allowance for doubtful accounts; the fair value assigned to assets acquired and liabilities assumed in business combinations; tax receivable agreement obligations; the fair value of interest rate swap obligations; contingent consideration; loss accruals; the carrying value of long-lived assets (including goodwill and intangible assets); the amortization period of long-lived assets (excluding goodwill); the carrying value, capitalization and amortization of software development costs; the provision and benefit for income taxes and related deferred tax accounts; certain accrued expenses; revenue recognition; contingencies; and the value attributed to equity awards.

***Recent Accounting Pronouncements***

In April 2014, the Financial Accounting Standards Board issued Accounting Standards Update No. 2014-08, which changes the requirements for reporting discontinued operations. Following adoption of this update, discontinued operations generally will be reported for the disposal by sale or otherwise of a component or a group of components that represents a strategic shift that has or will have a major effect on an entity s operations and financial results. This update is effective for fiscal years and interim periods beginning after December 15, 2014, with early adoption permitted. The Company is currently assessing whether to adopt this update prior to the required effective date.

**3. Concentration of Credit Risk**

The Company s revenue is primarily generated in the United States. Changes in economic conditions, government regulations or demographic trends, among other matters, in the United States could adversely affect the Company s revenue and results of operations.

The Company maintains its cash and cash equivalent balances in either insured depository accounts or money market mutual funds. The money market mutual funds are limited to investments in low-risk securities such as United States or government agency obligations, or repurchase agreements secured by such securities.

Table of Contents

**Emdeon Inc.**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited and amounts in thousands, except share and per share amounts)**

**4. Business Combinations**

In February 2014, the Company acquired all of the equity interests of Vieosoft, Inc. ( Vieosoft ), a development stage enterprise.

In June 2013, the Company acquired all of the equity interests of Goold Health Systems ( Goold ), a technology-enabled provider of pharmacy benefit and related services primarily to state Medicaid agencies across the nation.

The following table summarizes certain information related to these acquisitions. The preliminary values of the consideration transferred, assets acquired and liabilities assumed in the Vieosoft acquisition, including related tax effects, are subject to receipt of a final valuation.

| | Vieosoft | Goold |
|---|---|---|
| **Total Consideration Fair Value at Acquisition Date:** | | |
| Cash paid at closing | $ 800 | $ 19,391 |
| Contingent consideration | 6,015 | 5,553 |
| Other | | (5) |
| | $ 6,815 | $ 24,939 |
| **Allocation of the Consideration Transferred:** | | |
| Cash | $ 21 | $ 1,101 |
| Accounts receivable | | 3,435 |
| Prepaid expenses and other current assets | | 647 |
| Property and equipment | | 7,695 |
| Identifiable intangible assets: | | |
| Noncompetition agreements | 1,040 | 280 |
| Customer relationships | | 5,160 |
| Backlog and other | 2,060 | 460 |
| Goodwill | 6,325 | 14,300 |
| Accounts payable | | (541) |
| Accrued expenses | (194) | (2,076) |
| Deferred revenues | | (101) |
| Current maturities of long-term debt | (1,877) | (218) |
| Deferred income tax liabilities | (560) | (5,203) |
| Total consideration transferred | $ 6,815 | $ 24,939 |
| **Acquisition costs in sales, marketing, general and administrative expense:** | | |
| For the three months ended March 31, 2014 | $ 113 | $ |
| For the three months ended March 31, 2013 | $ | $ 4 |

Table of Contents

**Emdeon Inc.**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited and amounts in thousands, except share and per share amounts)**

| | Vieosoft | Goold |
|---|---|---|
| **Other Information:** | | |
| Gross contractual accounts receivable | $ | $ 3,435 |
| Amount not expected to be collected | $ | $ |
| Goodwill expected to be deductible for tax purposes | $ | $ |
| **Contingent Consideration Information:** | | |
| Contingent consideration range | $0 - $43,104 | $0 - $15,000 |
| Measurement period | February 12, 2014 to December 31, 2017 | July 1, 2013 to September 30, 2014 |
| Basis of measurement | Milestone achievement, revenue performance | Award of contracts with annual revenue exceeding targeted amount |
| Type of measurement | Level 3 | Level 3 |
| *Key assumptions at the acquisition date:* | | |
| Probability of achieving milestone objectives | 90% | N/A |
| Probability of winning new contracts | N/A | 10%-50% |
| Probability of retaining contracts that expire during the measurement period | N/A | 90% |
| Range of baseline revenue retention for existing customers | N/A | 75%-125% |
| Expected payment date(s) | 2015-2017 | 12/15/2014 |
| Discount rate(s) | 5.2% to 53.2% | 15.4% |
| *Increase (decrease) to net loss:* | | |
| For the three months ended March 31, 2014 | $ 227 | $ 1,733 |

The Company generally recognizes goodwill attributable to the assembled workforce and expected synergies among the operations of acquired entities and the Company s existing operations. In the case of the Company s acquisitions of operating companies, synergies generally have resulted from the elimination of duplicative facilities and personnel costs and cross selling opportunities among the Company s existing customer base.

Goodwill is generally deductible for federal income tax purposes when a business combination is treated as an asset purchase. Goodwill is generally not deductible for federal income tax purposes when the business combination is treated as a stock purchase.

Table of Contents

**Emdeon Inc.**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited and amounts in thousands, except share and per share amounts)**

**5. Goodwill and Intangible Assets**

Goodwill activity during the three months ended March 31, 2014 consisted of an increase to goodwill in the pharmacy services segment of $6,325 related to the Vieosoft acquisition in February 2014.

Intangible assets subject to amortization as of March 31, 2014 consisted of the following:

| | Weighted Average Remaining Life | Gross Carrying Amount | Accumulated Amortization | Net |
|---|---|---|---|---|
| Customer relationships | 17.1 | $ 1,646,970 | $ (202,111) | $ 1,444,859 |
| Trade names | 17.2 | 156,530 | (19,189) | 137,341 |
| Non-compete agreements | 2.6 | 14,120 | (6,434) | 7,686 |
| Data sublicense agreement | 3.5 | 31,000 | (12,656) | 18,344 |
| Other | 5.9 | 2,520 | (92) | 2,428 |
| Total | | $ 1,851,140 | $ (240,482) | $ 1,610,658 |

Amortization expense was $25,131 and $27,278 for the three months ended March 31, 2014 and 2013, respectively. Aggregate future amortization expense for intangible assets is estimated to be:

| | |
|---|---|
| 2014 (remainder) | $ 75,769 |
| 2015 | 100,618 |
| 2016 | 100,031 |
| 2017 | 96,756 |
| 2018 | 92,732 |
| Thereafter | 1,144,752 |
| | $ 1,610,658 |

Table of Contents

**Emdeon Inc.**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited and amounts in thousands, except share and per share amounts)**

**6. Long-Term Debt**

In November 2011, the Company entered into a credit agreement which was comprised of a senior secured term loan facility (the Term Loan Facility ), a revolving credit facility (the Revolving Facility ; together with the Term Loan Facility, the Senior Credit Facilities ), 11% senior notes due 2019 (the 2019 Notes ) and 11.25% senior notes due 2020 (the 2020 Notes ; together with the 2019 Notes, the Senior Notes ).

Long-term debt as of March 31, 2014 and December 31, 2013, consisted of the following:

| | March 31, 2014 | December 31, 2013 |
|---|---|---|
| *Senior Credit Facilities* | | |
| $1,301 million Senior Secured Term Loan facility, due November 2, 2018, net of unamortized discount of $15,063 and $15,826 at March 31, 2014 and December 31, 2013, respectively (effective interest rate of 4.21%) | $ 1,255,539 | $ 1,262,445 |
| $125 million Senior Secured Revolving Credit facility, expiring on November 2, 2016 and bearing interest at a variable base rate plus a spread rate | | |
| *Senior Notes* | | |
| $375 million 11% Senior Notes due December 31, 2019, net of unamortized discount of $7,438 and $7,664 at March 31, 2014 and December 31, 2013, respectively (effective interest rate of 11.53%) | 367,562 | 367,336 |
| $375 million 11.25% Senior Notes due December 31, 2020, net of unamortized discount of $9,336 and $9,560 at March 31, 2014 and December 31, 2013, respectively (effective interest rate of 11.86%) | 365,664 | 365,440 |
| *Obligation under data sublicense agreement* | 22,543 | 22,543 |
| Other | 9,620 | 12,592 |
| Less current portion | (18,972) | (31,330) |
| Long-term debt | $ 2,001,956 | $ 1,999,026 |

***Senior Credit Facilities***

The credit agreement governing the Senior Credit Facilities (the Senior Credit Agreement ) provides that, subject to certain conditions, the Company may request additional tranches of term loans, increase commitments under the Revolving Facility or the Term Loan Facility or add one or more incremental revolving credit facility tranches (provided that the revolving credit commitments outstanding at any time have no more than three different maturity dates) in an aggregate amount not to exceed (a) $300,000 plus (b) an unlimited amount at any time, subject to compliance on a pro forma basis with a first lien net leverage ratio of no greater than 4.00:1.00. Availability of such additional tranches of term loans or revolving credit facilities and/or increased commitments is subject to, among other conditions, the absence of any default under the Senior Credit Agreement and the receipt of commitments by existing or additional financial institutions. Proceeds of the Revolving Facility, including up to $30,000 in the form of borrowings on same-day notice, referred to as swingline loans, and up to $50,000 in the form of letters of credits, are available to provide financing for working capital and general corporate purposes.

Borrowings under the Senior Credit Facilities bear interest at an annual rate equal to an applicable margin plus, at the Company s option, either (a) a base rate determined by reference to the highest of (i) the applicable prime rate, (ii) the federal funds rate plus 0.50% and (iii) a LIBOR rate determined by reference to the costs of funds for United States dollar deposits for an interest period of one month, adjusted for certain additional costs, plus 1.00%, which base rate, in the case of the Term Loan Facility only, shall be no less than 2.25%, or (b) a LIBOR rate determined by reference to the costs of funds for United States dollar deposits for the interest period relevant to such borrowing, adjusted for certain additional costs, which, in the case of the Term Loan Facility only, shall be no less than 1.25%.

14

Table of Contents

**Emdeon Inc.**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited and amounts in thousands, except share and per share amounts)**

In April 2012, the Company amended the Senior Credit Agreement to reprice the Senior Credit Facilities and borrow $80,000 of additional term loans. Following this amendment, the LIBOR-based interest rate on the Term Loan Facility was LIBOR plus 3.75%, compared to the previous interest rate of LIBOR plus 5.50%. The new LIBOR-based interest rate on the Revolving Facility was LIBOR plus 3.50% (with a potential step-down to LIBOR plus 3.25% based on the Company s first lien net leverage ratio), compared to the previous interest rate of LIBOR plus 5.25% (with a potential step-down to LIBOR plus 5.00% based on the Company s first lien net leverage ratio).

In April 2013, the Company again amended the Senior Credit Agreement to further reprice, and also to modify certain financial covenants under, the Senior Credit Facilities. Following this amendment, the interest rate on the Term Loan Facility is LIBOR plus 2.50%, compared to the previous interest rate of LIBOR plus 3.75%. The new interest rate on the Revolving Facility is LIBOR plus 2.50%, compared to the previous interest rate of LIBOR plus 3.50% (or 3.25% based on a specified first lien net leverage ratio). The Term Loan Facility remains subject to a LIBOR floor of 1.25%, and there continues to be no LIBOR floor on the Revolving Facility. In connection with the April 2013 repricing, the Senior Credit Agreement also was amended to, among other things, eliminate the financial covenant related to the consolidated cash interest coverage ratio and modify the financial covenant related to the net leverage test by maintaining the required first lien net leverage ratio at its current level of 5.35 to 1.00 for the remaining term of the Senior Credit Facilities.

In addition to paying interest on outstanding principal under the Senior Credit Facilities, the Company is required to pay customary agency fees, letter of credit fees and a 0.50% commitment fee in respect of the unutilized commitments under the Revolving Facility.

The Senior Credit Agreement requires that the Company prepay outstanding loans under the Term Loan Facility, subject to certain exceptions, with (a) 100% of the net cash proceeds of any incurrence of debt other than debt permitted under the Senior Credit Agreement, (b) commencing with the fiscal year ended December 31, 2012, 50% (which percentage will be reduced to 25% and 0% based on the Company s first lien net leverage ratio) of the Company s annual excess cash flow and (c) 100% of the net cash proceeds of certain asset sales and casualty and condemnation events, subject to reinvestment rights and certain other exceptions.

The Company generally may voluntarily prepay outstanding loans under the Senior Credit Facilities at any time without premium or penalty other than breakage costs with respect to LIBOR loans; provided, however, the Company may be subject to a prepayment premium of 1.00% of the aggregate principal amount of the loans so prepaid based on the timing of certain repricing transactions.

The Company is required to make quarterly payments equal to 0.25% of the aggregate principal amount of the loans under the Term Loan Facility, with the balance due and payable on November 2, 2018. Any principal amount outstanding under the Revolving Facility is due and payable on November 2, 2016.

Certain of the Company s United States wholly-owned restricted subsidiaries, together with the Company, are co-borrowers and jointly and severally liable for all obligations under the Senior Credit Facilities. Such obligations of the co-borrowers are unconditionally guaranteed by Beagle Intermediate Holdings, Inc. (a direct wholly-owned subsidiary of Parent), the Company and each of its existing and future United States wholly-owned restricted subsidiaries (with certain exceptions including immaterial subsidiaries). These obligations are secured by a perfected security interest in substantially all of the assets of the co-borrowers and guarantors now owned or later acquired, including a pledge of all of the capital stock of the Company and its United States wholly-owned restricted subsidiaries and 65% of the capital stock of its foreign restricted subsidiaries, subject in each case to the exclusion of certain assets and additional exceptions.

Table of Contents

**Emdeon Inc.**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited and amounts in thousands, except share and per share amounts)**

The Senior Credit Agreement requires the Company to comply with a maximum first lien net leverage ratio financial maintenance covenant, to be tested on the last day of each fiscal quarter. A breach of the first lien net leverage ratio covenant is subject to certain equity cure rights. In addition, the Senior Credit Facilities contain a number of negative covenants that, among other things and subject to certain exceptions, restrict the Company s ability and the ability of its subsidiaries to:

- incur additional indebtedness or guarantees;
- incur liens;
- make investments, loans and acquisitions;
- consolidate or merge;
- sell assets, including capital stock of subsidiaries;
- pay dividends on capital stock or redeem, repurchase or retire capital stock of the Company or any restricted subsidiary;
- alter the business of the Company;
- amend, prepay, redeem or purchase subordinated debt;
- engage in transactions with affiliates; and
- enter into agreements limiting dividends and distributions of certain subsidiaries.

The Senior Credit Agreement also contains certain customary representations and warranties, affirmative covenants and provisions relating to events of default (including upon change of control).

***Senior Notes***

The 2019 Notes bear interest at an annual rate of 11.00% with interest payable semi-annually on June 30 and December 31 of each year. The 2019 Notes mature on December 31, 2019. The 2020 Notes bear interest at an annual rate of 11.25% with interest payable quarterly on March 31, June 30, September 30 and December 31 of each year. The 2020 Notes mature on December 31, 2020.

The Company may redeem the 2019 Notes, the 2020 Notes or both, in whole or in part, at any time on or after December 31, 2015 at the applicable redemption price, plus accrued and unpaid interest. In addition, at any time prior to December 31, 2014, the Company may, at its option and on one or more occasions, redeem up to 35% of the aggregate principal amount of the 2019 Notes or the 2020 Notes, at a redemption price equal to 100% of the aggregate principal amount, plus a premium equal to the stated interest rate on the 2019 Notes or the 2020 Notes, respectively, plus accrued and unpaid interest with the net cash proceeds of certain equity offerings; provided that at least 50% of the sum of the aggregate principal amount of the 2019 Notes or 2020 Notes, respectively, originally issued (including any additional notes) remain outstanding immediately after such redemption and the redemption occurs within 180 days of the equity offering. At any time prior to December 31, 2015, the Company may redeem the 2019 Notes, the 2020 Notes or both, in whole or in part, at its option and on one or more occasions, at a redemption price equal to 100% of the principal amount, plus an applicable premium and accrued and unpaid interest. If the Company experiences specific kinds of changes in control, it must offer to purchase the Senior Notes at a purchase price equal to 101% of the principal amount, plus accrued and unpaid interest.

The Senior Notes are senior unsecured obligations and rank equally in right of payment with all of the Company s existing and future indebtedness and senior in right of payment to all of its existing and future subordinated indebtedness. The Company s obligations under the Senior Notes are guaranteed on a senior basis by all of its existing and subsequently acquired or organized wholly-owned United States restricted subsidiaries that guarantee the Senior Credit Facilities or its other indebtedness or indebtedness of any affiliate guarantor. The Senior Notes and the related guarantees are effectively subordinated to the Company s existing and future secured obligations and that of its affiliate guarantors to the extent of the value of the collateral securing such obligations, and are structurally subordinated to all existing and future indebtedness and other liabilities of any of the Company s subsidiaries that do not guarantee the Senior Notes.

Table of Contents

**Emdeon Inc.**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited and amounts in thousands, except share and per share amounts)**

The indentures governing the Senior Notes (the Indentures ) contain customary covenants that restrict the ability of the Company and its restricted subsidiaries to:

- pay dividends on capital stock or redeem, repurchase or retire capital stock;
- incur additional indebtedness or issue certain capital stock;
- incur certain liens;
- make investments, loans, advances and acquisitions;
- consolidate, merge or transfer all or substantially all of their assets and the assets of their subsidiaries;
- prepay subordinated debt;
- engage in certain transactions with affiliates; and
- enter into agreements restricting the subsidiaries ability to pay dividends.

The Indentures also contain certain customary affirmative covenants and events of default.

***Obligation Under Data Sublicense Agreement***

In October 2009 and April 2010, the Company acquired certain additional rights to specified uses of its data from the former owner of the Company s business in order to broaden the Company s ability to pursue business intelligence and data analytics solutions for payers and providers. The Company previously licensed exclusive rights to this data to the former owner of the Company s business. In connection with these data rights acquisitions, the Company recorded amortizable intangible assets and corresponding obligations at inception based on the present value of the scheduled annual payments through 2018, which totaled $65,000 in the aggregate (approximately $30,000 remained payable at March 31, 2014). In connection with the Merger, the Company was required to adjust this obligation to its fair value.

***Other***

From time to time, the Company enters into deferred financing arrangements with certain vendors. The obligations under such arrangements are recorded at the present value of the scheduled payments. Such future payments totaled $9,841 at March 31, 2014.

**7. Interest Rate Swap**

***Risk Management Objective of Using Derivatives***

The Company is exposed to certain risks arising from both its business operations and economic conditions. The Company principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. The Company manages economic risks, including interest rate, liquidity and credit risk, primarily by managing the amount, sources and duration of its debt funding and the use of derivative financial instruments. Specifically, the Company enters into derivative financial instruments to manage exposures that arise from business activities that result in the receipt or payment of future known and uncertain cash amounts, the value of which are determined by interest rates. The Company s derivative financial instruments are used to manage differences in the amount, timing and duration of the Company s known or expected cash receipts and its known or expected cash payments principally related to the Company s borrowings.

***Cash Flow Hedges of Interest Rate Risk***

The Company s objectives in using interest rate derivatives are to add stability to interest expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company primarily uses interest rate swaps as part of its interest rate risk management strategy. During the three months ended March 31, 2014, such derivatives were used to hedge the variable cash flows associated with existing variable-rate debt pursuant to the Term Loan Facility. As of March 31, 2014, the Company had three outstanding interest rate derivatives with a combined notional amount of $640,000 that were designated as cash flow hedges of interest rate risk.

Table of Contents

**Emdeon Inc.**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited and amounts in thousands, except share and per share amounts)**

The effective portion of changes in the fair value of derivatives designated and that qualify as cash flow hedges is recorded in accumulated other comprehensive income and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings. Amounts reported in accumulated other comprehensive income related to derivatives will be reclassified to interest expense as interest payments are made on the Company s variable-rate debt. During the next twelve months, the Company estimates that an additional $2,576 will be reclassified as an increase to interest expense.

The following table summarizes the fair value of the Company s derivative instruments at March 31, 2014 and December 31, 2013:

| | | Fair Values of Derivative Instruments Asset (Liability) Derivatives | |
|---|---|---|---|
| | Balance Sheet Location | March 31, 2014 | December 31, 2013 |
| **Derivatives designated as hedging instruments:** | | | |
| Interest rate swaps | Other assets | $ 690 | $ 899 |
| Interest rate swaps | Accrued expenses | (2,576) | (2,575) |
| | | $ (1,886) | $ (1,676) |

***Tabular Disclosure of the Effect of Derivative Instruments on the Statement of Operations***

The effect of the derivative instruments on the accompanying unaudited condensed consolidated statements of operations for the three months ended March 31, 2014 and 2013, respectively, is summarized in the following table:

| | Three Months Ended March 31, 2014 | Three Months Ended March 31, 2013 |
|---|---|---|
| **Derivatives in Cash Flow Hedging Relationships** | | |
| (Gain)/loss related to effective portion of derivative recognized in other comprehensive income | $ 848 | $ 44 |
| Gain/(loss) related to effective portion of derivative reclassified from accumulated other comprehensive income (loss) to interest expense | $ (638) | $ (638) |

***Credit Risk-related Contingent Features***

The Company has agreements with each of its derivative counterparties that contain a provision where if the Company defaults on any of its indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender, then the Company also could be declared in default on its derivative obligations.

As of March 31, 2014, the termination value of derivatives in a net liability position, which includes accrued interest but excludes any adjustment for nonperformance risk, related to these agreements was $2,601. If the Company had breached any of these provisions at March 31, 2014, the Company could have been required to settle its obligations under the agreements at this termination value. The Company does not offset any derivative instruments and the derivative instruments are not subject to collateral posting requirements.

Table of Contents

**Emdeon Inc.**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited and amounts in thousands, except share and per share amounts)**

**8. Fair Value Measurements**

***Assets and Liabilities Measured at Fair Value on a Recurring Basis***

The Company s assets and liabilities that are measured at fair value on a recurring basis consist of the Company s derivative financial instruments and contingent consideration associated with business combinations. The table below summarizes these items as of March 31, 2014, aggregated by the level in the fair value hierarchy within which those measurements fall.

| Description | Balance at March 31, 2014 | Quoted in Markets Identical (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Interest rate swaps | $ (1,886) | $ | $ (1,886) | $ |
| Contingent consideration obligations | (13,459) | | | (13,459) |
| Total | $ (15,345) | $ | $ (1,886) | $ (13,459) |

The valuation of the Company s derivative financial instruments is determined using widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivative, including the period to maturity, and uses observable market-based inputs, including interest rate curves. The fair value of the interest rate swaps are determined using the market standard methodology of netting the discounted future fixed cash payments (or receipts) and the discounted expected variable cash receipts (or payments) using the overnight index swap rate as the discount rate.

The Company incorporates credit valuation adjustments to appropriately reflect both its own nonperformance risk and the respective counterparty s nonperformance risk in the fair value measurements. In adjusting the fair value of its derivative contracts for the effect of nonperformance risk, the Company has considered the impact of netting and any applicable credit enhancements and measures the credit risk of its derivative financial instruments that are subject to master netting agreements on a net basis by counterparty portfolio.

Although the Company has determined that the majority of the inputs used to value its derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilize Level 3 inputs to evaluate the likelihood of default by itself and by its counterparties. As of March 31, 2014, the Company determined that the credit valuation adjustments are not significant to the overall valuation of its derivatives. As a result, the Company determined that its derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

The valuation of the Company s contingent consideration obligations is estimated as the present value of total expected contingent consideration payments which are determined using a Monte Carlo simulation. This analysis reflects the contractual terms of the purchase agreements and utilizes assumptions with regard to future sales, probabilities of achieving such future sales, the likelihood and timing of expected payments and a discount rate. Significant increases with respect to assumptions as to future sales and probabilities of achieving such future sales would result in a higher fair value measurement, while an increase in the discount rate would result in a lower fair value measurement.

Table of Contents

**Emdeon Inc.**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited and amounts in thousands, except share and per share amounts)**

The table below presents a reconciliation of the fair value of the liabilities that use significant unobservable inputs (Level 3).

**Fair Value Measurements Using Significant Unobservable Inputs (Level 3)**

| | Three Months Ended March 31, 2014 | Three Months Ended March 31, 2013 |
|---|---|---|
| Balance at beginning of period | $ (5,484) | $ (296) |
| Issuance of contingent consideration | (6,015) | |
| Settlement of contingent consideration | | 59 |
| Total changes included in contingent consideration | (1,960) | |
| Balance at end of period | $ (13,459) | $ (237) |

***Assets and Liabilities Measured at Fair Value upon Initial Recognition***

The carrying amount and the estimated fair value of financial instruments held by the Company as of March 31, 2014 were:

| | Carrying Amount | Fair Value |
|---|---|---|
| Cash and cash equivalents | $ 76,899 | $ 76,899 |
| Accounts receivable | $ 215,198 | $ 215,198 |
| Senior Credit Facilities (Level 1) | $ 1,255,539 | $ 1,272,190 |
| Senior Notes (Level 2) | $ 733,226 | $ 874,223 |

The carrying amounts of cash equivalents and accounts receivable approximate fair value because of their short-term maturities. The fair value of long-term debt is based upon market quotes and trades by investors in partial interests of these instruments.

**9. Legal Proceedings**

The Company has accrued an estimated potential loss of $5,000 related to a vendor fee dispute. While the recorded amount represents the Company s current estimate, it is reasonably possible that future events confirming the loss and an estimate of the amount of loss may occur. In addition, the amount of loss could differ significantly from the current estimate.

Additionally, in the normal course of business, the Company is involved in various claims and legal proceedings. While the ultimate resolution of these matters has yet to be determined, the Company does not believe that their outcomes will have a material adverse effect on the Company s consolidated financial position, results of operations or liquidity.

**10. Income Taxes**

In January 2014, the Company effected a change in the tax status of EBS Master LLC ( EBS Master ) from a partnership to a corporation. Prior to the tax status change, the Company recognized a deferred tax liability for the difference in the book and tax basis of its investment in EBS

Master (i.e. outside basis). Following the tax status change, the Company s deferred tax balances reflect the differences in the book and tax bases of the individual assets and liabilities included in the corporation. In addition, as a result of the change in tax status, the Company was required to revise the apportionment of its income taxes among various state taxing jurisdictions. The effect of this change in tax status resulted in the recognition of an income tax benefit for the three months ended March 31, 2014.

Table of Contents

**Emdeon Inc.**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited and amounts in thousands, except share and per share amounts)**

After giving effect to this change in tax status, income taxes for the three months ended March 31, 2014 amounted to an income tax benefit of $21,266 and an effective tax rate of 87.7%. The income tax benefit for the three months ended March 31, 2013, which does not reflect the change in tax status, was $9,357 and resulted in an effective tax rate of 41.0%.

**11. Tax Receivable Agreement Obligation to Related Parties**

In connection with the IPO, the Company entered into tax receivable agreements which obligated the Company to make payments to certain current and former owners of the Company, including affiliates of Hellman and Friedman ( H&F ) and certain members of management, equal to 85% of the applicable cash savings that the Company realizes as a result of tax attributes arising from certain previous transactions. The Company will retain the benefit of the remaining 15% of these tax savings.

In November 2011, H&F and certain current and former members of management exchanged all of their remaining EBS Master Units ( EBS Units ) for cash and a combination of cash and shares of Parent, respectively, and the former majority owner of the Company assigned its rights under the tax receivable agreements to affiliates of Blackstone (Blackstone, together with H&F and certain current and former members of management are sometimes referred to collectively as the TRA Members ). Additionally, effective December 31, 2011, the Company simplified its corporate structure. The tax attributes of the exchange of EBS Units and corporate restructuring are expected to provide the Company with additional cash savings, 85% of which are payable to the TRA Members. Collectively, the Company expects the tax attributes of the above referenced events to result in cumulative payments under the tax receivable agreements of approximately $353,457. $151,394 of this amount, which reflected the initial fair value of the tax receivable agreement obligations plus recognized accretion, was reflected as an obligation on the accompanying unaudited condensed consolidated balance sheet at March 31, 2014.

During the three months March 31, 2014, the Company changed its estimate of the timing and amount of future cash flows attributable to the tax receivable agreements as a result of the effective tax rate resulting from the change in tax status of EBS Master from a partnership to a corporation and the acquisition of Vieosoft. These revised estimates resulted in a decrease to pretax net loss of $4,570 for the three months ended March 31, 2014.

**12. Segment Reporting**

Effective January 1, 2014, the Company completed an internal reorganization of its reporting structure which resulted in a change in the composition of its operating segments. Additionally, the Company periodically makes other changes to the composition of its operating segments. Prior period segment information is restated to reflect the organizational structure and any other changes made.

Management views the Company s operating results in three reportable segments: (a) payer services, (b) provider services and (c) pharmacy services. Listed below are the results of operations for each of the reportable segments. In addition to these reportable segments, the Company reports financial information for two additional operating segments that is presented on an aggregate basis. This information is reflected in the manner utilized by management to make operating decisions, assess performance and allocate resources. Segment assets are not presented to management for purposes of operational decision making, and therefore are not included in the accompanying tables. The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies in the notes to the Company s audited consolidated financial statements included in the Annual Report on Form 10-K for the year ended December 31, 2013 as filed with the SEC.

***Payer Services Segment***

The payer services segment provides payment cycle solutions that simplify the administration of healthcare related to insurance eligibility and benefit verification, claims management, payment integrity and payment distribution. Additionally, the payer services segment provides patient billing and payment and consulting services.

21

Table of Contents

**Emdeon Inc.**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited and amounts in thousands, except share and per share amounts)**

***Provider Services Segment***

The provider services segment provides revenue cycle management solutions, government program eligibility and enrollment services and revenue optimization solutions primarily to hospitals, physician practices, laboratories and other healthcare providers that simplify providers revenue cycle and workflow, reduce related costs and improve cash flow.

***Pharmacy Services Segment***

The pharmacy services segment provides electronic prescribing services, other electronic solutions and benefit administration services to pharmacies, pharmacy benefit management companies, government agencies and other payers related to prescription benefit claim filing, adjudication and management.

***All Other***

All Other consists of two operating segments, one of which provides revenue cycle management solutions through channel partners and one of which provides revenue cycle solutions, either directly or through channel partners, to dental practices.

***Corporate and Eliminations***

Inter-segment revenue and expenses primarily represent claims management and patient billing and payment services provided between segments.

Corporate and eliminations includes management, administrative and other shared corporate services functions such as information technology, legal, finance, human resources, marketing and product management, as well as eliminations to remove inter-segment revenue and expenses. These administrative and other shared services costs are excluded from the adjusted EBITDA measure for each respective operating segment.

Table of Contents

**Emdeon Inc.**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited and amounts in thousands, except share and per share amounts)**

The revenue and adjusted EBITDA for the operating segments are as follows:

| | Three Months Ended March 31, 2014 | | | | | |
|---|---|---|---|---|---|---|
| | Payer | Provider | Pharmacy | All Other | Corporate and Eliminations | Consolidated |
| Revenue from external customers: | | | | | | |
| Claims management | $ 69,652 | $ | $ | $ | $ | $ 69,652 |
| Payment distribution services | 66,799 | | | | | 66,799 |
| Patient billing and payment services | 67,932 | | | | | 67,932 |
| Revenue cycle technology | | 30,691 | | | | 30,691 |
| Revenue cycle services | | 30,407 | | | | 30,407 |
| Physician services | | 9,139 | | | | 9,139 |
| Pharmacy | | | 31,192 | | | 31,192 |
| Channel Partner | | | | 10,788 | (5,340) | 5,448 |
| Dental | | | | 7,947 | | 7,947 |
| Inter-segment revenue | 2,189 | | 77 | | (2,266) | |
| Net revenue | $ 206,572 | $ 70,237 | $ 31,269 | $ 18,735 | $ (7,606) | $ 319,207 |
| Income (loss) before income taxes | | | | | | $ (24,255) |
| Interest expense | | | | | | 36,563 |
| Depreciation and amortization | | | | | | 46,463 |
| EBITDA | | | | | | 58,771 |
| Equity compensation | | | | | | 1,892 |
| Acquisition accounting adjustments | | | | | | 252 |
| Acquisition-related costs | | | | | | 1,407 |
| Transaction-related costs and advisory fees | | | | | | 1,500 |
| Strategic initiatives, duplicative and transition costs | | | | | | 5,094 |
| Severance and retention costs | | | | | | 2,928 |
| Accretion | | | | | | (77) |
| (Gain) loss on disposal of assets | | | | | | 3,067 |
| Contingent consideration | | | | | | 1,960 |
| Other | | | | | | 1,511 |
| EBITDA Adjustments | | | | | | 19,534 |
| Adjusted EBITDA | $ 64,489 | $ 29,683 | $ 16,946 | $ 9,786 | $ (42,599) | $ 78,305 |

Table of Contents

**Emdeon Inc.**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited and amounts in thousands, except share and per share amounts)**

| | Three Months Ended March 31, 2013 | | | | | |
|---|---|---|---|---|---|---|
| | Payer | Provider | Pharmacy | All Other | Corporate and Eliminations | Consolidated |
| Revenue from external customers: | | | | | | |
| Claims management | $ 67,306 | $ | $ | $ | $ | $ 67,306 |
| Payment distribution services | 65,629 | | | | | 65,629 |
| Patient billing and payment services | 62,933 | | | | | 62,933 |
| Revenue cycle technology | | 28,311 | | | | 28,311 |
| Revenue cycle services | | 30,349 | | | | 30,349 |
| Physician services | | 8,762 | | | | 8,762 |
| Pharmacy | | | 24,553 | | | 24,553 |
| Channel Partner | | | | 9,657 | (6,343) | 3,314 |
| Dental | | | | 8,202 | | 8,202 |
| Inter-segment revenue | 982 | | 95 | | (1,077) | |
| Net revenue | $ 196,850 | $ 67,422 | $ 24,648 | $ 17,859 | $ (7,420) | $ 299,359 |
| Income (loss) before income taxes | | | | | | $ (22,808) |
| Interest expense | | | | | | 41,415 |
| Depreciation and amortization | | | | | | 46,815 |
| EBITDA | | | | | | 65,422 |
| Equity compensation | | | | | | 1,775 |
| Acquisition accounting adjustments | | | | | | 274 |
| Acquisition-related costs | | | | | | 497 |
| Transaction-related costs and advisory fees | | | | | | 1,500 |
| Strategic initiatives, duplicative and transition costs | | | | | | 1,159 |
| Severance and retention costs | | | | | | 886 |
| Accretion | | | | | | 4,140 |
| (Gain) loss on disposal of assets | | | | | | (31) |
| Other | | | | | | 422 |
| EBITDA Adjustments | | | | | | 10,622 |
| Adjusted EBITDA | $ 61,428 | $ 30,716 | $ 14,913 | $ 8,696 | $ (39,709) | $ 76,044 |

Table of Contents

**Emdeon Inc.**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited and amounts in thousands, except share and per share amounts)**

**13. Accumulated Other Comprehensive Income (Loss)**

The following is a summary of the accumulated other comprehensive income (loss) balances, net of taxes, as of and for the three months ended March 31, 2014.

| | Foreign Currency Translation Adjustment | Cash Flow Hedge | Accumulated Other Comprehensive Income (Loss) |
|---|---|---|---|
| Balance at January 1, 2014 | $ (264) | $ (1,079) | $ (1,343) |
| Change associated with foreign currency translation | (73) | | (73) |
| Change associated with current period hedging | | (762) | (762) |
| Reclassification into earnings | | 638 | 638 |
| Balance at March 31, 2014 | $ (337) | $ (1,203) | $ (1,540) |

**14. Supplemental Condensed Consolidating Financial Information**

In lieu of providing separate annual and interim financial statements for each guarantor of the Senior Notes, Regulation S-X provides companies, if certain criteria are satisfied, with the option to instead provide condensed consolidating financial information for its issuers, guarantors and non-guarantors. In the case of the Company, the applicable criteria include the following: (i) the Senior Notes are fully and unconditionally guaranteed on a joint and several basis, (ii) each of the guarantors of the Senior Notes is a direct or indirect wholly-owned subsidiary of the Company and (iii) any non-guarantors are considered minor as that term is defined in Regulation S-X. Because each of these criteria has been satisfied by the Company, condensed consolidating balance sheets as of March 31, 2014 and December 31, 2013, condensed consolidating statements of operations and comprehensive income (loss) for the three months ended March 31, 2014 and 2013, respectively, and condensed consolidating cash flows for the three months ended March 31, 2014 and 2013, respectively, for the Company, segregating the issuer, the subsidiary guarantors and consolidating adjustments, are reflected below. Prior period amounts have been reclassified to conform to the current year presentation.

Table of Contents

**Emdeon Inc.**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited and amounts in thousands, except share and per share amounts)**

**Condensed Consolidating Balance Sheet**

| | As of March 31, 2014 | | | |
|---|---|---|---|---|
| | Emdeon Inc. | Guarantor Subsidiaries | Consolidating Adjustments | Consolidated |
| **ASSETS** | | | | |
| Current assets: | | | | |
| Cash and cash equivalents | $ 726 | $ 76,173 | $ | $ 76,899 |
| Accounts receivable, net of allowance for doubtful accounts | | 215,198 | | 215,198 |
| Deferred income tax assets | | 14,371 | | 14,371 |
| Prepaid expenses and other current assets | 7,363 | 22,272 | | 29,635 |
| Total current assets | 8,089 | 328,014 | | 336,103 |
| Property and equipment, net | 9 | 254,485 | | 254,494 |
| Due from affiliates | | 88,640 | (88,640) | |
| Investment in consolidated subsidiaries | 1,744,699 | | (1,744,699) | |
| Goodwill | | 1,508,759 | | 1,508,759 |
| Intangible assets, net | 140,250 | 1,470,408 | | 1,610,658 |
| Other assets, net | 115,290 | 15,967 | (111,402) | 19,855 |
| Total assets | $ 2,008,337 | $ 3,666,273 | $ (1,944,741) | $ 3,729,869 |
| **LIABILITIES AND EQUITY** | | | | |
| Current liabilities: | | | | |
| Accounts payable | $ | $ 6,889 | $ | $ 6,889 |
| Accrued expenses | 18,576 | 117,002 | | 135,578 |
| Deferred revenues | | 10,416 | | 10,416 |
| Current portion of long-term debt | 5,481 | 13,491 | | 18,972 |
| Total current liabilities | 24,057 | 147,798 | | 171,855 |
| Due to affiliates | 88,640 | | (88,640) | |
| Long-term debt, excluding current portion | 775,992 | 1,225,964 | | 2,001,956 |
| Deferred income tax liabilities | | 534,061 | (111,402) | 422,659 |
| Tax receivable agreement obligations to related parties | 150,419 | | | 150,419 |
| Other long-term liabilities | | 13,751 | | 13,751 |
| Commitments and contingencies | | | | |
| Equity | 969,229 | 1,744,699 | (1,744,699) | 969,229 |
| Total liabilities and equity | $ 2,008,337 | $ 3,666,273 | $ (1,944,741) | $ 3,729,869 |

Table of Contents

**Emdeon Inc.**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited and amounts in thousands, except share and per share amounts)**

**Condensed Consolidating Balance Sheet**

| | As of December 31, 2013 | | | |
|---|---|---|---|---|
| | Emdeon Inc. | Guarantor Subsidiaries | Consolidating Adjustments | Consolidated |
| **ASSETS** | | | | |
| Current assets: | | | | |
| Cash and cash equivalents | $ 2,794 | $ 73,744 | $ | $ 76,538 |
| Accounts receivable, net of allowance for doubtful accounts | | 214,247 | | 214,247 |
| Deferred income tax assets | | 6,317 | | 6,317 |
| Prepaid expenses and other current assets | 3,441 | 23,578 | | 27,019 |
| Total current assets | 6,235 | 317,886 | | 324,121 |
| Property and equipment, net | 10 | 269,460 | | 269,470 |
| Due from affiliates | | 69,142 | (69,142) | |
| Investment in subsidiaries | 1,764,213 | | (1,764,213) | |
| Goodwill | | 1,502,434 | 440,408 | 411,628 |

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2012 | 2011 | 2010 | 2009 | 2008 |
| Other Data: | | | | | |
| Cash flow provided by (used in) operating activities | $68,822 | $61,441 | $73,194 | $71,751 | $(3,610) |
| Cash flow used in investing activities | (1,048) | (30,560) | (4,173) | (74,956) | (148,942) |
| Cash flow provided by (used in) financing activities | 98,721 | (30,050) | (198) | 532 | 12,406 |
| Depreciation | 38,275 | 40,227 | 35,559 | 32,717 | 26,462 |
| Stock-based compensation expense | 10,974 | 9,108 | 13,177 | 13,191 | 13,501 |
| Capital expenditures[6] | 19,323 | 46,957 | 49,038 | 37,190 | 61,936 |

(1) These line items include the following amounts of non-cash, stock-based compensation expense for the periods indicated:

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2012 | 2011 | 2010 | 2009 | 2008 |
| Cost of sales | $1,401 | $1,412 | $1,301 | $1,285 | $1,244 |
| Selling, general and administrative | 8,898 | 7,028 | 9,924 | 10,077 | 10,644 |
| Research and development | 675 | 668 | 1,952 | 1,829 | 1,613 |

(2) During the year ended December 31, 2012 and 2011, we recorded pre-tax charges associated with the cost improvement restructuring efforts totaling $1.6 million and $16.9 million. During the years ended December 31, 2010, 2009, and 2008, we recorded pre-tax charges associated with the restructuring of our facilities in Toulon and

Creteil, France, totaling $0.9 million, $3.5 million, and $6.7 million, respectively. See Note 16 to our consolidated financial statements contained in “Financial Statements and Supplementary Data” for a detailed discussion of these activities and the associated charges.

(3) During the year ended December 31, 2008, we recorded $2.5 million of in-process research and development charges associated with our acquisition of Inbone Technologies, Inc.

(4) During the year ended December 31, 2012, we recorded income of $15 million related to a sale and license back transaction for intellectual property.

(5) During the year ended December 31, 2008, we recorded a tax provision of $12.8 million to adjust our valuation allowance, primarily to record a valuation allowance against all of our remaining deferred tax assets associated with net operating losses in France.

(6) During the years ended December 31, 2010, 2009 and 2008, our capital expenditures included approximately $6.0 million, $5.9 million and $16.9 million, respectively, related to the expansion of our Arlington, Tennessee facilities.

(7) During the years ended December 31, 2012, 2011, 2010, 2009 and 2008, we recorded approximately $6.6 million, $12.9 million, $10.9 million, $7.8 million, and $7.6 million of expenses associated with the U.S. government inquiries, respectively, and, in 2012, 2011 and 2010, the Deferred Prosecution Agreement.

(8) During the year ended December 31, 2012, we recognized approximately $2.7 million for the write-off of unamortized deferred financing fees associated with the termination of our Senior Credit facility and the redemption of approximately $25 million of our 2014 Convertible Notes. Additionally, we recognized approximately $1.1 million of charges for the mark to market adjustment of our derivative instruments. During the year ended December 31, 2011, we recognized approximately $4.1 million for the write off of pro-rata unamortized deferred financing fees and transaction costs associated with the tender offer

Table of Contents

for our convertible notes completed during the first quarter of 2011. During the year ended December 31, 2009, we recorded a $2.6 million write off of the cumulative translation adjustment (CTA) balances from certain subsidiaries following the substantially complete liquidation of these entities.

Table of Contents

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

The following management's discussion and analysis of financial condition and results of operations describes the principal factors affecting the results of our operations, financial condition and changes in financial condition, as well as our critical accounting estimates.

Executive Overview

Company Description. We are a global orthopaedic medical device company operating as two reportable business segments based on the two primary markets that we operate within: Extremities and OrthoRecon. We specialize in the design, manufacture and marketing of devices and biologic products for extremity, hip, and knee repair and reconstruction.

Our Extremities segment includes products that are used primarily in foot and ankle repair, upper extremity products, and biologics products, which are used to replace damaged or diseased bone, to stimulate bone growth and to provide other biological solutions for surgeons and their patients. Extremity hardware includes implants and other devices to replace or reconstruct injured or diseased joints and bones of the foot, ankle, hand, wrist, elbow and shoulder, which we generally refer to as either foot and ankle or upper extremity products. We are a leading provider of surgical solutions for the foot and ankle market. Our extensive foot and ankle product portfolio, our approximately 200 specialized foot and ankle sales representatives, and our increasing level of training of foot and ankle surgeons has resulted in our being a recognized leader in the foot and ankle market. Biologics are used to repair or replace damaged or diseased bone, to stimulate bone growth and to provide other biological solutions for surgeons and their patients.

Our OrthoRecon segment includes products that are used primarily to replace or repair knee, hip and bones that have deteriorated or have been damaged through disease or injury. Reconstructive devices are used to replace or repair knee, hip and other joints and bones that have deteriorated or been damaged through disease or injury.

We have been in business for over 60 years and have built a well-known and respected brand name.

Our corporate headquarters and U.S. operations are located in Arlington, Tennessee, where we conduct research and development, sales and marketing administration, manufacturing, warehousing and administrative activities. Our U.S. sales accounted for 57% of total revenue in 2012. Outside the U.S., we have distribution and administrative facilities in Amsterdam, the Netherlands, and sales and distribution offices in Canada, Japan and throughout Europe. As of December 31, 2012, through a combination of our direct sales offices and approximately 80 stocking distribution partners, we have approximately 750 international sales representatives that sell our products in approximately 60 countries.

Principal Products. We primarily sell devices and biologic products for extremity, hip, and knee repair and reconstruction. We specialize in extremity and biologic products used by extremity focused surgeon specialists for the reconstruction, trauma and arthroscopy markets. Our biologics sales encompass a broad portfolio of products designed to stimulate and augment the natural regenerative capabilities of the human body. We also sell orthopaedic products not considered to be part of our knee, hip, extremity or biologic product lines.

Our extremities product line includes products for both the foot and ankle and the upper extremity markets. Our principal foot and ankle portfolio includes the INBONE™ total ankle system, the CLAW® II Polyaxial Compression Plating System, the ORTHOLOC™ 3Di Reconstruction Plating System, the PRO-TOE® EVO Hammertoe System, the DARCO® family of locked plating systems, the VALOR™ ankle fusion nail system, and the Swanson line of toe joint replacement products. Our upper extremity portfolio includes the MICRONAIL® intramedullary wrist fracture repair system, the EVOLVE® radial head prosthesis for elbow fractures, the RAYHACK® osteotomy system, and the EVOLVE® Elbow Plating System.

Our biologic products focus on biological musculoskeletal repair and include synthetic and human tissue-based materials. Our principal biologic products include the GRAFTJACKET® line of soft tissue repair and containment membranes, the ALLOMATRIX® line of injectable tissue-based bone graft substitutes, the PRO-DENSE® injectable regenerative graft, the OSTEOSET® synthetic bone graft substitute, and the PRO-STIM™ injectable inductive graft.

Our knee reconstruction products position us well in the areas of total knee reconstruction, revision replacement implants and limb preservation products. Our principal knee products are the EVOLUTION™ Medial-Pivot Knee System, and the ADVANCE® knee system.

Our hip joint reconstruction product portfolio provides offerings in the areas of bone-conserving implants, total hip reconstruction, revision replacement implants and limb preservation. Our hip reconstruction products include the PROFEMUR® family of hip stems, and the DYNASTY™ acetabular cup system.

Significant Business Developments. Net sales declined 6% in 2012, totaling $483.8 million, compared to $512.9 million in 2011, as growth in our foot and ankle business was more than offset by declines in our other product lines.

Table of Contents

Our 2012 domestic sales declined 7%, as a 12% increase in our U.S. foot and ankle sales was more than offset by a 15% decline in our OrthoRecon segment, which was negatively affected by customer losses associated with distributor transitions and challenges associated with implementing enhancements to our compliance processes. In addition, our U.S. biologics sales decreased 16% due in part to the impact of our 2011 agreement with Kinetic Concepts, Inc. (KCI) where we licensed our GRAFTJACKET® brand to KCI for exclusive use in wound markets, which precluded us from marketing our GRAFTJACKET® products in the wound care field beginning July 1, 2011. Our international sales decreased by 4% during 2012 as compared to 2011 driven primarily by pricing decreases in Japan and unfavorable foreign currency exchange rates.

In 2012, net income totaled $5.3 million, compared to a net loss of $5.1 million in 2011. Items favorably impacting net income in 2012 as compared to 2011 included:

- a $15.3 million ($9.7 million net of taxes) decrease in restructuring charges;
- a $15.0 million ($9.6 million net of taxes) gain on the sale of certain internally-developed intellectual property recognized during 2012;
- a $13.2 million ($8.5 million net of taxes) provision for product liability associated with modular necks recognized during 2011; and
- a $6.3 million ($3.6 million net of taxes) decrease in expenses associated with the deferred prosecution agreement and U.S. governmental inquiries.

Items unfavorably impacting net income in 2012 included:

- charges of $4.1 million ($2.6 million net of taxes) associated with transitioning a major portion of our U.S. independent distributor foot and ankle territories to direct employee sales representation;
- charges of $8.4 million ($5.2 million net of taxes) associated with the issuance of our 2017 Convertible Senior Notes and termination of our amended and restated revolving credit agreement (Senior Credit Facility); and
- decreased profitability in our OrthoRecon segment, primarily driven by sales declines.

During 2012, we converted a major portion of our U.S. foot and ankle distributor territories to direct sales representation. We believe this increase in U.S. direct foot and ankle sales representation, coupled with our large and growing product portfolio and increased investment in medical education, will enable us to continue improving our growth rates in foot and ankle. In conjunction with our U.S. foot and ankle sales force conversions, we entered into agreements with certain distributors, which included non-compete clauses. As a result, we recorded $9.3 million of non-compete intangible assets and recognized $3.0 million of associated amortization expenses. Additionally we recorded $1.0 million of expenses related to this conversion during 2012. We will recognize amortization expense related to these conversions over the next two years, which will have a negative impact on our profitability.

In August 2012, we issued $300 million of 2.000% Convertible Senior Notes (2017 Notes), which generated net proceeds of $290.8 million. We used $130 million of the proceeds from the issuance of the 2017 Notes to repay the $150 million under a delayed draw term loan (Term Loan) under our Senior Credit Facility and to terminate the Senior Credit Facility. In connection with the offering of the 2017 Notes, we entered into convertible note hedging transactions with three counterparties (the Option Counterparties). We also entered into warrant transactions in which we sold warrants for an aggregate of 11.8 million shares of our common stock to the Option Counterparties. We paid the Option Counterparties approximately $56.2 million for the convertible note hedge and received approximately $34.6 million from the Option Counterparties for the warrants. See Notes 8 and 10 for additional information regarding these transactions.

We used $25.3 million of the proceeds from the issuance of the 2017 Notes to repurchase a portion of outstanding principal of our 2014 Convertible Senior Notes (2014 Notes). As of December 31, 2012, $3.8 million aggregate principal amount of the 2014 Notes remain outstanding.

Our Deferred Prosecution Agreement (DPA) expired on September 29, 2012. On October 5, 2012, we received notice that the United States Attorney's Office (USAO) dismissed the pending criminal complaint filed in September 2010 against us. Upon the expiration of the DPA, our amended Corporate Integrity Agreement (CIA) became effective. See additional discussion of our DPA and CIA in Significant Industry Factors.

In November 2012, we announced that Pascal E.R. Girin was named Executive Vice President and Chief Operating Officer. Mr. Girin has global responsibility for our Extremities and OrthoRecon businesses, and Clinical, Regulatory

and Quality. In addition, we announced a new divisional structure, whereby we created an Extremities division and an OrthoRecon division. Eric Stookey, formerly our Chief Commercial Officer, was promoted to President of our Extremities division and Ted Davis, formerly our Senior Vice President of Corporate Development, was promoted to President of our OrthoRecon division.

In November 2012, we announced that we entered into a definitive agreement with BioMimetic for a business combination of Wright and BioMimetic. BioMimetic is focused on developing regenerative medicine products to promote the healing of

Table of Contents

musculoskeletal injuries and diseases with a novel protein therapeutic product, Augment® Bone Graft, under late stage FDA review as a replacement for autologous bone graft in foot and ankle fusions. The transaction will combine BioMimetic's breakthrough biologics platform and pipeline with our established sales force and product portfolio, to further accelerate growth in our Extremities business. Under the terms of the agreement, the transaction has a total potential value for BioMimetic shareholders of $380 million, based on our closing stock price on November 16, 2012, including an upfront payment of $1.50 in cash and 0.2482 shares of Wright common stock per share of BioMimetic stock, valued at approximately $190 million. Each BioMimetic share will also receive one tradable Contingent Value Right (CVR), which entitles its holder to receive additional cash payments of up to $6.50 per share, which are payable upon receipt of FDA approval of Augment® Bone Graft and upon achieving certain revenue milestones. We expect the transaction to close in the first quarter of 2013, subject to customary closing conditions, including BioMimetic shareholder approval. A BioMimetic shareholder vote is scheduled for February 26, 2013.

Opportunities and Challenges. We believe that we have an opportunity to transform our business to increase our foot and ankle revenue growth rates, stabilize our OrthoRecon business, and increase our cash generation through significant reduction of our inventories. We made changes in 2012 to realize these opportunities, including aggressively converting a portion of our U.S. independent distributor foot and ankle territories to direct sales representation, substantially increasing our investment in foot and ankle medical education to drive market adoption of new products and technologies, and implementing steps to significantly reduce inventories over the next several years. As a result, our foot and ankle business grew 14% compared to 2011 and we generated $49.5 million of free cash flow during 2012. As we move into 2013, we expect to build on this momentum with new initiatives to increase sales productivity by reducing non-revenue generating activities, improve gross margins and stabilize our OrthoRecon business.

Our U.S. OrthoRecon business will continue to be unfavorably affected by the full-year impact of customer losses and revenue dis-synergies associated with our U.S. foot and ankle sales force conversion in 2012. Our international OrthoRecon businesses will be negatively impacted by the full-year impact of Japan pricing declines.

Beginning in 2013, we will be subject to a 2.3% excise tax on U.S. sales of medical devices, as prescribed in the Affordable Care Act. This tax will have a negative impact on our profitability.

Significant Industry Factors. Our industry is affected by numerous competitive, regulatory, and other significant factors. The growth of our business relies on our ability to continue to develop new products and innovative technologies, obtain regulatory clearance and compliance for our products, protect the proprietary technology of our products and our manufacturing processes, manufacture our products cost-effectively, respond to competitive pressures specific to each of our geographic markets, including our ability to enforce non-compete agreements, and successfully market and distribute our products in a profitable manner. We, and the entire industry, are subject to extensive governmental regulation, primarily by the FDA. Failure to comply with regulatory requirements could have a material adverse effect on our business. Additionally, our industry is highly competitive and has recently experienced increased pricing pressures, specifically in the areas of reconstructive joint devices.

In December 2007, we received a subpoena from the United States Department of Justice (DOJ) through the United States Attorney’s Office for the District of New Jersey (USAO) requesting documents for the period January 1998 through the present related to any consulting and professional service agreements with orthopaedic surgeons in connection with hip or knee joint replacement procedures or products. This subpoena was served shortly after several of our knee and hip competitors agreed with the DOJ to resolutions of similar investigations.

On September 29, 2010, WMT, entered into a 12-month Deferred Prosecution Agreement (DPA) with the USAO and a Civil Settlement Agreement (CSA) with the United States. Under the DPA, the USAO filed a criminal complaint in the United States District Court for the District of New Jersey charging WMT with conspiracy to commit violations of the Anti-Kickback Statute (42 U.S.C. § 1320a-7b) during the years 2002 through 2007. The court deferred prosecution of the criminal complaint during the term of the DPA and the USAO agreed that if WMT complied with the DPA's provisions, the USAO would seek dismissal of the criminal complaint.

Pursuant to the CSA, WMT settled civil and administrative claims relating to the matter for a payment of $7.9 million without any admission by WMT. In conjunction with the CSA, WMT also entered into a five year Corporate Integrity Agreement (CIA) with the Office of the Inspector General of the United States Department of Health and Human

Services (OIG-HHS). Pursuant to the DPA, an independent monitor reviewed and evaluated WMT's compliance with its obligations under the DPA. The DPA and the CIA were filed as Exhibits 10.3 and 10.2, respectively, to our current report on Form 8-K filed on September 30, 2010. The DPA was also posted to our website. Each of the DPA and the CIA could be modified by mutual consent of the parties thereto.

On September 15, 2011, WMT reached an agreement with the USAO and the OIG-HHS under which WMT voluntarily agreed to extend the term of its DPA for 12 months, to September 29, 2012. On September 15, 2011, WMT also agreed with the OIG-HHS to an amendment to the CIA under which certain of WMT's substantive obligations under the CIA would begin on September 29, 2012, when the amended DPA monitoring period expired. The term of the CIA has not changed, and will expire as previously provided on September 29, 2015.

Table of Contents

On October 4, 2012, the USAO issued a press release announcing that the amended DPA had expired on September 29, 2012, that it had moved to dismiss the criminal complaint against WMT because WMT had fully complied with the terms of the DPA, and that the Court had ordered dismissal of the complaint on October 4, 2012.

The DPA imposed, and the CIA continues to impose, certain obligations on WMT to maintain compliance with U.S. healthcare laws, regulations and other requirements. Our failure to do so could expose us to significant liability including, but not limited to, exclusion from federal healthcare program participation, including Medicaid and Medicare, which would have a material adverse effect on our financial condition, results of operations and cash flows, potential prosecution, civil and criminal fines or penalties, and additional litigation cost and expense.

In addition to the USAO and OIG-HHS, other governmental agencies, including state authorities, could conduct investigations or institute proceedings that are not precluded by the terms of the settlements reflected in the DPA and the CIA. In addition, the settlement with the USAO and OIG-HHS could increase our exposure to lawsuits by potential whistleblowers, including under the federal false claims acts, based on new theories or allegations arising from the allegations made by the USAO. The costs of defending or resolving any such investigations or proceedings could have a material adverse effect on our financial condition, results of operations and cash flows.

The successful implementation of our enhanced compliance program requires the full and sustained cooperation of our employees, distributors, and sales agents as well as the healthcare professionals with whom they interact. These efforts may require increased expenses and additional investments. We may also encounter inefficiencies in the implementation of our new compliance enhancements, including delays in medical education, research and development projects, and clinical studies, which may unfavorably impact our business and our relationships with customers.

A detailed discussion of these and other factors is provided in “Risk Factors.”

We market metal-on-metal hip (MoM) arthroplasty systems. On June 27 and June 28, 2012, FDA's Orthopaedic and Rehabilitation Devices Panel of the Medical Devices Advisory Committee met and discussed the safety and effectiveness of MoM hip arthroplasty systems. FDA sought expert scientific and clinical opinion on the risks and benefits of MoM hip arthroplasty systems from the Committee and the public. In January 2013, the FDA proposed a new regulation requiring that all MoM hip implants undergo the full PMA process, with supportive clinical data. This regulation applies to currently marketed devices, as well as those entering the market for the first time. FDA has not provided a date for final implementation and enforcement of this new requirement.

Table of Contents

Results of Operations

Comparison of the year ended December 31, 2012 to the year ended December 31, 2011

The following table sets forth, for the periods indicated, our results of operations expressed as dollar amounts (in thousands) and as percentages of net sales:

| | Year Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2012 | | | 2011 | | |
| | Amount | % of Sales | | Amount | % of Sales | |
| Net sales | $483,776 | 100.0 | % | $512,947 | 100.0 | % |
| Cost of sales[1] | 149,978 | 31.0 | % | 156,906 | 30.6 | % |
| Cost of sales - restructuring | 435 | 0.1 | % | 2,471 | 0.5 | % |
| Gross profit | 333,363 | 68.9 | % | 353,570 | 68.9 | % |
| Operating expenses: | | | | | | |
| Selling, general and administrative[1] | 290,261 | 60.0 | % | 301,588 | 58.8 | % |
| Research and development[1] | 27,033 | 5.6 | % | 30,114 | 5.9 | % |
| Amortization of intangible assets | 5,772 | 1.2 | % | 2,870 | 0.6 | % |
| Gain on sale of intellectual property | (15,000) | (3.1)% | | — | — | % |
| Restructuring charges | 1,153 | 0.2 | % | 14,405 | 2.8 | % |
| Total operating expenses | 309,219 | 63.9 | % | 348,977 | 68.0 | % |
| Operating income | 24,144 | 5.0 | % | 4,593 | 0.9 | % |
| Interest expense, net | 10,188 | 2.1 | % | 6,529 | 1.3 | % |
| Other expense, net | 5,395 | 1.1 | % | 4,719 | 0.9 | % |
| Income (loss) before income taxes | 8,561 | 1.8 | % | (6,655) | (1.3)% | |
| Provision (benefit) for income taxes | 3,277 | 0.7 | % | (1,512) | (0.3)% | |
| Net income (loss) | $5,284 | 1.1 | % | $(5,143) | (1.0)% | |

[1] These line items include the following amounts of non-cash, stock-based compensation expense for the periods indicated:

| | Year Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2012 | % of Sales | | 2011 | % of Sales | |
| Cost of sales | $1,401 | 0.3 | % | $1,412 | 0.3 | % |
| Selling, general and administrative | 8,898 | 1.8 | % | 7,028 | 1.4 | % |
| Research and development | 675 | 0.1 | % | 668 | 0.1 | % |

Table of Contents

The following table sets forth our net sales by product line for the periods indicated (in thousands) and the percentage of year-over-year change:

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | 2012 | 2011 | % Change | |
| OrthoRecon | | | | |
| Hip | $150,550 | $173,201 | (13.1 | )% |
| Knees | 114,896 | 123,988 | (7.3 | )% |
| Other | 4,225 | 5,005 | (15.6 | )% |
| Total OrthoRecon | 269,671 | 302,194 | (10.8 | )% |
| | | | | |
| Extremities | | | | |
| Foot and Ankle | 122,897 | 107,734 | 14.1 | % |
| Upper Extremity | 24,977 | 27,742 | (10.0 | )% |
| Biologics | 60,495 | 69,409 | (12.8 | )% |
| Other | 5,736 | 5,868 | (2.2 | )% |
| Total Extremities | 214,105 | 210,753 | 1.6 | % |
| | | | | |
| Total Sales | $483,776 | $512,947 | (5.7 | )% |

The following table presents net sales by geographic area (in thousands) and the percentage of year-over-year change:

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | 2012 | 2011 | % Change | |
| Geographic | | | | |
| Domestic | $275,686 | $295,943 | (6.8 | )% |
| International | 208,090 | 217,004 | (4.1 | )% |
| Total Sales | $483,776 | $512,947 | (5.7 | )% |

Net sales. Net sales totaled $483.8 million in 2012, compared to $512.9 million in 2011, representing a 6% decline. U.S. net sales totaled $275.7 million in 2012, a 7% decline from $295.9 million in 2011, representing approximately 57% of total net sales in 2012 and 58% of total net sales in 2011. Our international net sales totaled $208.1 million in 2012, a 4% decrease as compared to net sales of $217.0 million in 2011. Our 2012 international net sales included an unfavorable foreign currency impact of approximately $5.3 million when compared to 2011 net sales.

Extremities Segment: Net sales in our Extremities segment increased 2% to $214.1 million in 2012, from $210.8 million in 2011.

Our foot and ankle sales increased 14% to $122.9 million in 2012 from $107.7 million in 2011, driven by the success of our CLAW® II Polyaxial Compression Plating System and our ORTHOLOC™ 3Di Reconstruction Plating System, both launched in the first half of 2012, as well as the successful conversion of the majority of our foot & ankle sales force to direct representation. International foot and ankle sales grew 26%, as increased sales across all geographies were partially offset by $0.8 million of unfavorable currency exchange rates.

Upper extremity net sales decreased to $25.0 million in 2012, representing a 10% decline from 2011, driven by a 13% decline in the U.S.

Net sales of our biologics products decreased 13% to $60.5 million in 2012, compared to $69.4 million in 2011. Our U.S. biologics sales declined 16% as a result of lower sales volume due, in part, to the impact of the KCI agreement, which precluded us from marketing our GRAFTJACKET® products in the wound care field beginning July 1, 2011.

OrthoRecon Segment: Our OrthoRecon sales decreased 11% to $269.7 million in 2012 compared to $302.1 million in 2011.

Our hip product net sales totaled $150.6 million in 2012 compared to $173.2 million in 2011, representing a 13% decline. This decrease is attributable to an 18% decline in U.S. hip sales, driven primarily by a 12% decrease in sales volume as the result of customer losses. International hip sales decreased by 8% compared to 2011, driven by a 9%

price decline in Japan due to lower governmental reimbursement rates, and an 8% decrease in Europe driven primarily by lower sales to our stocking distributors. In addition, international hip sales were negatively impacted by $2.7 million of unfavorable currency exchange rates.

Table of Contents

Net sales of our knee products decreased 7% to $114.9 million in 2012 compared to $124.0 million in 2011. In the U.S., knee sales decreased 13% from 2011, due primarily to decreased sales volumes attributable to lost customers and sales dis-synergies related to the U.S. sales force conversion initiative. International knee sales were relatively flat, as an 8% increase in our European direct markets and higher sales in our international stocking distributors were offset by a 5% price decline in Japan due to lower governmental reimbursement rates and $1.3 million of unfavorable currency exchange rates.

Cost of sales. Our cost of sales as a percentage of net sales increased slightly in 2012 compared to 2011 from 30.6% to 31.0%, due to unfavorable geographic mix, unfavorable currency exchange rates, and higher manufacturing expenses, partially offset by decreased provisions for excess and obsolete inventory and favorable product mix to our foot and ankle products.

Our cost of sales and corresponding gross profit percentages can be expected to fluctuate in future periods depending upon changes in our product sales mix and prices, distribution channels and geographies, manufacturing yields, period expenses, levels of production volume and currency exchange rates.

Cost of sales - restructuring. In 2011, we recorded charges of $2.5 million for excess and obsolete inventory provisions associated with product optimization as we reduced the size of our international product portfolio. During 2012, we completed our cost restructuring recognizing an additional $0.4 million for excess and obsolete inventory provisions.

Selling, general and administrative. Our selling, general and administrative expenses as a percentage of net sales totaled 60.0% and 58.8% in 2012 and 2011, respectively. For 2012, selling, general and administrative expense included $8.9 million (1.8% of net sales) of non-cash stock-based compensation expense, $6.6 million (1.4% of net sales) of costs associated with our U.S. Government inquiries and our DPA, $1.0 million (0.2% of net sales) of costs associated with U.S. distributor conversions, and $1.8 million (0.4% of net sales) of due diligence and transaction costs associated with our pending acquisition of BioMimetic. Selling, general and administrative expense for 2011 included $7.0 million (1.4% of net sales) of non-cash stock based compensation expense, $12.9 million (2.5% of net sales) of costs associated with U.S. government inquiries and our DPA, $1.8 million (0.3% of net sales) of costs associated with certain employment matters and the hiring of a new CEO, and a charge of $13.2 million (2.6% of net sales) for management's estimate for product liability provisions. The remaining increase in selling, general and administrative expense was driven by increased sales and marketing costs as a result of our initiative to convert a substantial portion of our U.S. foot and ankle sales force to direct employees, costs associated with increased levels of medical education, and the impact of fixed general and administrative expenses in relation to lower sales. Additionally, we recognized increased cash incentive compensation as compared to 2011, when we incurred lower expense associated with cash incentive compensation, as we failed to meet most incentive compensation targets.

Research and development. Our investment in research and development activities represented 5.6% and 5.9% of net sales in 2012 and 2011, respectively. The decrease in research and development expense as a percentage of sales is primarily attributable to cost reductions resulting from our cost improvement restructuring plan initiated in the third quarter of 2011 and lower costs associated with clinical studies.

Amortization of intangible assets. Charges associated with amortization of intangible assets totaled $5.8 million in 2012, as compared to $2.9 million in 2011. During 2012, we recorded $3.0 million of amortization expense associated with distributor non-compete agreements entered into during the year. Based on the intangible assets held at December 31, 2012, we expect to amortize $6.7 million in 2012, $4.1 million in 2013, $2.3 million in 2014, $2.0 million in 2015 and $1.6 million in 2016.

Gain on Sale of Intellectual Property. During 2012, we recognized a gain of $15.0 million related to the sale of certain intellectual property associated with biomaterial used in products marketed and sold by us as bone graft substitutes. In connection with the sale, we entered into a license agreement with the purchaser pursuant to which we obtained an exclusive, worldwide, fully paid license to use the transferred intellectual property in our fields of use.

Restructuring Charges. During 2011, we recognized $14.4 million of restructuring charges within operating expenses, primarily for severance obligations and the impairment of long-lived assets. During 2012, we completed our cost restructuring recognizing $1.2 million of charges.

Interest expense, net. Interest expense, net, consists of interest expense of $10.6 million in 2012, primarily from borrowings under our 2017 Convertible Senior Notes, borrowings under the Term Loan and non-cash interest expense associated with the amortization of the discount on our 2017 Convertible Senior Notes. Interest expense, net, consists of interest expense of $7.0 million in 2011, primarily from borrowings under the Term Loan. Interest income of $0.4 million was recognized during 2012 and 2011, generated by our invested cash balances and investments in marketable securities. The amounts of interest income we realize in 2013 and beyond are subject to variability, dependent upon both the rate of invested returns we realize and the amount of excess cash balances on hand. Additionally, the amount of interest expense we incur is subject to variability dependent upon the change in London Interbank Offered Rate (LIBOR) rates and our consolidated leverage ratio.

Other expense, net. For 2012, other expense, net includes a $1.8 million loss on the early termination of an interest rate swap, $2.7 million related to the write off of deferred financing costs associated with our terminated Senior Credit Facility and the portion of our 2014 Notes that were repurchased, and a net unrealized loss of $1.1 million for mark-to-market adjustments on our derivative

Table of Contents

assets and derivative liabilities. For 2011, other expense, net includes approximately $4.1 million of expenses in 2011 for the write off of pro-rata unamortized deferred financing fees and for bank and legal fees associated with the purchase of $170.9 million aggregate principal amount of the 2014 Notes validly tendered in the 2011 tender offer.

Provision (benefit) for income taxes. We recorded tax expense of $3.3 million in 2012 and tax benefit of $1.5 million in 2011. Our effective tax rate for 2012 and 2011 was 38.3% and 22.7%, respectively. Our 2011 tax benefit included the unfavorable impact of a $1.0 million provision associated with the initial assessments from the examination of our 2008 income tax return by the Internal Revenue Service. Our effective tax rate for 2012 does not include the impact of the R&D tax credit, which was not enacted into law until January 2, 2013. Because the R&D tax credit was reinstated retroactively to the beginning of 2012, our 2013 effective tax rate will include this benefit.

Reportable Segments.

The following table sets forth, for the periods indicated, sales gross profit and operating income of our reportable segments expressed as dollar amounts (in thousands) and as a percentage of net sales:

| | OrthoRecon | | | Extremities | | |
|---|---|---|---|---|---|---|
| | Year Ended December 31, | | | | | |
| | 2012 | 2011 | | 2012 | 2011 | |
| Net Sales | $269,671 | $302,194 | | $214,105 | $210,753 | |
| Gross Profit | 168,627 | 202,727 | | 166,730 | 154,857 | |
| Gross Profit as a percent of net sales | 62.5 | % 67.1 | % | 77.9 | % 73.5 | % |
| Operating Income | $33,527 | $60,895 | | $49,481 | $46,989 | |
| Operating Income as a percent of net sales | 12.4 | % 20.2 | % | 23.1 | % 22.3 | % |

OrthoRecon Segment: Gross profit as a percent of sales decreased to 62.5% in 2012 from 67.1% in 2011 due to unfavorable geographic mix, unfavorable currency exchange rates, and higher manufacturing expenses. Operating income as a percentage of sales decreased to 12.4% in 2012 from 20.2% in 2011, driven by the decrease in gross profit as a percent of sales, increased legal spending, and the impact of other operating expenses on lower sales.

Extremities Segment: Gross profit as a percent of sales increased to 77.9% in 2012 from 73.5% in 2011, primarily due to lower provisions for excess and obsolete inventory. Operating income as a percentage of sales increased to 23.1% in 2012 from 22.3% in 2011, as favorable gross profit was partially offset by increased investments in our direct U.S. foot and ankle sales force and medical education.

Table of Contents

Comparison of the year ended December 31, 2011 to the year ended December 31, 2010

The following table sets forth, for the periods indicated, our results of operations expressed as dollar amounts (in thousands) and as percentages of net sales:

| | Year Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2011 | | | 2010 | | |
| | Amount | % of Sales | | Amount | % of Sales | |
| Net sales | $512,947 | 100.0 | % | $518,973 | 100.0 | % |
| Cost of sales[1] | 156,906 | 30.6 | % | $158,456 | 30.5 | % |
| Cost of sales - restructuring | 2,471 | 0.5 | % | $— | — | % |
| Gross profit | 353,570 | 68.9 | % | 360,517 | 69.5 | % |
| Operating expenses: | | | | | | |
| Selling, general and administrative[1] | 301,588 | 58.8 | % | 282,413 | 54.4 | % |
| Research and development[1] | 30,114 | 5.9 | % | 37,300 | 7.2 | % |
| Amortization of intangible assets | 2,870 | 0.6 | % | 2,711 | 0.5 | % |
| Restructuring charges | 14,405 | 2.8 | % | 919 | 0.2 | % |
| Total operating expenses | 348,977 | 68.0 | % | 323,343 | 62.3 | % |
| Operating income | 4,593 | 0.9 | % | 37,174 | 7.2 | % |
| Interest expense, net | 6,529 | 1.3 | % | 6,123 | 1.2 | % |
| Other expense, net | 4,719 | 0.9 | % | 130 | 0.0 | % |
| (Loss) income before income taxes | (6,655) | (1.3) | % | 30,921 | 6.0 | % |
| (Benefit) provision for income taxes | (1,512) | (0.3) | % | 13,080 | 2.5 | % |
| Net income | $(5,143) | (1.0) | % | $17,841 | 3.4 | % |

[1] These line items include the following amounts of non-cash, stock-based compensation expense for the periods indicated:

| | Year Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2011 | % of Sales | | 2010 | % of Sales | |
| Cost of sales | $1,412 | 0.3 | % | $1,301 | 0.3 | % |
| Selling, general and administrative | 7,028 | 1.4 | % | 9,924 | 1.9 | % |
| Research and development | 668 | 0.1 | % | 1,952 | 0.4 | % |

41

Table of Contents

The following table sets forth our net sales by product line for the periods indicated (in thousands) and the percentage of year-over-year change:

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | 2011 | 2010 | % Change | |
| OrthoRecon | | | | |
| Hip | $173,201 | $176,687 | (2.0 | )% |
| Knees | 123,988 | 128,854 | (3.8 | )% |
| Other | 5,005 | 4,943 | 1.3 | % |
| Total OrthoRecon | 302,194 | 310,484 | (2.7 | )% |
| | | | | |
| Extremities | | | | |
| Foot and Ankle | 107,734 | 97,971 | 10.0 | % |
| Upper Extremity | 27,742 | 26,519 | 4.6 | % |
| Biologics | 69,409 | 79,231 | (12.4 | )% |
| Other | 5,868 | 4,768 | 23.1 | % |
| Total Extremities | 210,753 | 208,489 | 1.1 | % |
| | | | | |
| Total Sales | $512,947 | $518,973 | (1.2 | )% |

The following table presents net sales by geographic area (in thousands) and the percentage of year-over-year change:

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | 2011 | 2010 | % Change | |
| Geographic | | | | |
| Domestic | $295,943 | 309,983 | (4.5 | )% |
| International | 217,004 | 208,990 | 3.8 | % |
| Total Sales | $512,947 | $518,973 | (1.2 | )% |

Net sales. Our U.S. net sales totaled $295.9 million in 2011 and $310.0 million in 2010, representing approximately 58% of total net sales in 2011, 60% of total net sales in 2010, and a 5% decrease in 2011 compared to 2010. Our international net sales totaled $217.0 million in 2011, a 4% increase as compared to net sales of $209.0 million in 2010. Our 2011 international net sales included a favorable foreign currency impact of approximately $10.6 million when compared to 2010 net sales. The favorable currency impact and a 7% increase in sales in Japan were partially offset by a 5% decrease in sales in Europe.

OrthoRecon sales decreased 3% compared to 2010. Our hip product net sales totaled $173.2 million in 2011, representing a 2% decrease over 2010. This decrease is attributable to a 14% decline in U.S. hip sales, driven by an 11% decline in unit sales. The remaining decrease was driven by a decline in average selling prices. International hip sales increased by 6%, attributable to a $6.4 million favorable currency impact compared to 2010. Net sales of our knee products totaled $124.0 million in 2011, representing a decrease of 4% over 2010. In the U.S., knee sales decreased 4% over 2010 due primarily to decreased average selling prices. Internationally, knee sales decreased 4% in 2011 over 2010, primarily due to lower unit sales, which was partially offset by a favorable currency impact of $2.0 million.

Our Extremities segment sales increased 1%, driven by 10% growth in our foot and ankle sales and 5% growth in upper extremity sales, offset by a 12% decrease in biologics sales. Foot and ankle growth was driven by a 9% increase in our U.S. foot and ankle business due primarily to our PRO-TOE™ VO Hammertoe Fixation System, launched in the first quarter of 2011, as well as the continued success of our INBONE™ products and our VALOR™ ankle fusion nail system, launched in the 2nd quarter of 2010. International foot and ankle sales growth of 16% was primarily due to the continued success of our DARCO plating system as well as a favorable currency exchange rates.

Net sales of our biologic products totaled $69.4 million in 2011, which declined by 12%, as compared to 2010. Our U.S. biologics sales decreased 15% compared to 2010, primarily due to the license agreement entered into with KCI during the first quarter of 2011.

Table of Contents

Cost of sales.

Our cost of sales as a percentage of net sales increased slightly in 2011 compared to 2010 from 30.5% to 30.6% as increased provisions for excess and obsolete inventory were mostly offset by favorable manufacturing expenses and favorable currency exchange rates.

Cost of sales - restructuring.

In 2011, we recorded charges of $2.5 million (0.5% of net sales) for excess and obsolete inventory provisions associated with product optimization as we reduced the size of our international product portfolio.

Selling, general and administrative.

Our selling, general and administrative expenses as a percentage of net sales totaled 58.8% and 54.4% in 2011 and 2010, respectively. Selling, general and administrative expense for 2011 included $7.0 million of non-cash stock-based compensation expense, $12.9 million of costs associated with U.S. government inquiries and our DPA, $1.8 million of costs associated with certain employment matters and the hiring of a new CEO, and a charge of $13.2 million for management's estimate for product liability provisions. During 2010, selling, general and administrative expense included $9.9 million of non-cash stock based compensation expense and $10.9 million of costs associated with our U.S. government inquiries and our DPA. The remaining increase in selling, general and administrative expenses as percent of net sales is the result of increased spending on our global compliance efforts and legal fees, which were partially offset by decreased spending on medical education.

Research and development.

Our investment in research and development activities represented 5.9% and 7.2% of net sales in 2011 and 2010, respectively. The decrease in research and development expense as a percentage of sales is primarily attributable to decreased non-cash, stock-based compensation expenses and lower spending on research and development activities and clinical studies as we encountered certain inefficiencies associated with the implementation of our enhanced compliance program.

Amortization of intangible assets.

Charges associated with amortization of intangible assets were relatively flat as a percentage of net sales, totaling $2.9 million or 0.6% of sales in 2011, as compared to $2.7 million or 0.5% of sales in 2010.

Restructuring Charges.

During 2011, we recognized $14.4 million of restructuring charges within operating expenses, primarily for severance obligations and the impairment of long-lived assets.

Interest expense, net.

Interest expense, net, consists of interest expense of $7.0 million and $6.6 million in 2011 and 2010, respectively, primarily from borrowings under the Term Loan for 2011 under our Senior Credit Facility, and our 2014 Notes for 2010, offset by interest income of $0.4 million and $0.5 million during 2011 and 2010, respectively, generated by our invested cash balances and investments in marketable securities.

Other expense, net.

Other expense, net includes approximately $4.1 million of expenses in 2011 for the write off of pro-rata unamortized deferred financing fees and for bank and legal fees associated with the purchase of $170.9 million aggregate principal amount of the Notes validly tendered in the tender offer.

(Benefit)/Provision for income taxes.

We recorded tax benefit of $1.5 million in 2011 and tax provision of $13.1 million in 2010. Our as reported effective tax rate for 2011 and 2010 was 22.7% and 42.3% respectively. Our 2011 tax benefit included the unfavorable impact of a $1.0 million provision associated with the initial assessments from the examination of our 2008 income tax return by the Internal Revenue Service.

Reportable Segments.

The following table sets forth, for the periods indicated, sales gross profit and operating income of our reportable segments expressed as dollar amounts (in thousands) and as a percentage of net sales:

Table of Contents

| | OrthoRecon | | | Extremities | | |
|---|---|---|---|---|---|---|
| | Year Ended December 31, | | | | | |
| | 2011 | 2010 | | 2011 | 2010 | |
| Net Sales | $302,194 | $310,484 | | $210,753 | $208,489 | |
| Gross Profit | 202,727 | 208,552 | | 154,857 | 153,266 | |
| Gross Profit as a percent of net sales | 67.1 | % 67.2 | % | 73.5 | % 73.5 | % |
| Operating Income | $60,895 | $55,295 | | $46,989 | $44,700 | |
| Operating Income as a percent of net sales | 20.2 | % 17.8 | % | 22.3 | % 21.4 | % |

OrthoRecon: Operating income increased to $60.9 million in 2011 from $55.3 million in 2010, primarily due to lower levels of spending on research and development activities and clinical studies as we encountered certain inefficiencies associated with the implementation of our enhanced compliance program, partially offset by a decrease in profitability as a result of the sales decline.

Extremities: Extremities gross profit as a percentage of sales was flat year over year. Operating income increased to $47.0 million in 2011 compared to $44.7 million in 2010 driven by increased sales and a decrease in selling, general and administrative costs compared to 2010.

Seasonal Nature of Business

We traditionally experience lower sales volumes in the third quarter than throughout the rest of the year as many of our reconstructive products are used in elective procedures, which generally decline during the summer months, typically resulting in selling, general and administrative expenses and research and development expenses as a percentage of sales that are higher during this period than throughout the rest of the year. In addition, our first quarter selling, general and administrative expenses include additional expenses that we incur in connection with the annual meeting held by the American Academy of Orthopaedic Surgeons (AAOS) and the American College of Foot and Ankle Surgeons (ACFAS). The AAOS meeting, which is the largest orthopaedic meeting in the world, features the presentation of scientific papers and instructional courses for orthopaedic surgeons. During this three-day event, we display our most recent and innovative products for these surgeons. The ACFAS meeting, similar to AAOS, is another three-day event to display our latest innovations in the foot and ankle market.

Restructuring

On September 15, 2011, we announced plans to implement a cost restructuring plan to foster growth, enhance profitability and cash flow, and build stockholder value. We have implemented numerous initiatives to reduce spending, including streamlining select aspects of our international selling and distribution operations, reducing the size of our product portfolio, adjusting plant operations to align with our volume and mix expectations and rationalizing our research and development projects. In total, we reduced our workforce by approximately 80 employees, or 6%. We concluded our cost improvement restructuring efforts during the second quarter of 2012, however certain liabilities remain to be paid at December 31, 2012. We have realized the benefits from this restructuring within selling, general and administrative expenses and research and development expenses beginning in the fourth quarter of 2011. This favorability is being partially offset by unfavorable income tax consequences, and incremental expenses associated with senior management changes. In total, our net income will have an approximately $2 million favorable impact beginning in 2012 on an annual basis. Additionally, beginning in 2013, we expect to realize additional benefits within cost of sales, the net income impact of which is approximately $1 million annually. However, the favorable impact from our cost improvement restructuring plan in 2012 was more than offset by the additional investments we made in 2012 for the transformational changes discussed above in “Opportunities and Challenges.” See Note 16 to our condensed consolidated financial statements for further discussion of our restructuring charges.

Liquidity and Capital Resources

The following table sets forth, for the periods indicated, certain liquidity measures (in thousands):

| | As of December 31, | |
|---|---|---|
| | 2012 | 2011 |
| Cash and cash equivalents | $320,360 | $153,642 |
| Short-term marketable securities | 12,646 | 13,597 |

| | | |
|---|---|---|
| Long-term marketable securities | — | 4,502 |
| Working capital | 575,713 | 424,543 |
| Line of credit availability | — | 42,000 |

Table of Contents

Operating Activities. Cash provided by operating activities totaled $68.8 million, $61.4 million, and $73.2 million in 2012, 2011 and 2010 respectively. The increase in cash provided by operating activities in 2012 as compared to 2011 was driven by increased cash profitability and inventory reductions, partially offset by payments of approximately $10 million to buy out certain royalty agreements with health care professionals.

In 2011 compared to 2010, the decrease in cash from operating activities was primarily due to decreased profitability, primarily associated with cash paid for restructuring charges of approximately $9.9 million.

Investing Activities. Our capital expenditures totaled $19.3 million in 2012, $47.0 million in 2011, and $49.0 million in 2010. The decrease in 2012 compared to 2011 is attributable to decreased spending on surgical instrumentation as a result of our inventory and instrumentation optimization efforts, and the 2011 spending on instrumentation related to the launch of our EVOLUTION™ Medial-Pivot Knee System. In addition, 2011 included spending related to the upgrade of our enterprise resource planning system. Capital expenditures remained relatively flat in 2011 compared to 2010. Historically, our capital expenditures have consisted principally of purchased manufacturing equipment, research and testing equipment, computer systems, office furniture and equipment and surgical instruments. We expect to incur capital expenditures in 2013 of approximately $30 million for routine capital expenditures.

Financing Activities. During 2012, cash provided by financing activities totaled $98.7 million, compared to cash used in financing activities in 2011 of $30.1 million and cash used in financing activities of $0.2 million in 2010. During 2012, cash provided by financing activities consisted primarily of $300.0 million of proceeds from the issuance of our 2017 Convertible Senior Notes, offset by payments on our Term Loan of $144.4 million and $56.2 million of cash used to purchase hedge options on our 2017 Notes. During 2011, cash used in financing activities consisted of the purchase of $170.9 million of our 2014 Notes tendered in the tender offer, mostly offset by the cash proceeds from a $150 million borrowing under the Term Loan.

In 2012, we will make continued payments under our long-term capital leases, including interest, of $0.8 million.

On August 22, 2012, we issued $300 million of 2.000% Convertible Senior Notes, which generated net proceeds of $290.8 million. In connection with the offering of the 2017 Notes, we entered into convertible note hedging transactions with three counterparties. We also entered into warrant transactions in which we sold warrants for an aggregate of 11.8 million shares of our common stock to the counterparties. We paid the counterparties approximately $56.2 million for the convertible note hedge and received approximately $34.6 million from the counterparties for the warrants. See Notes 8 and 10 for additional information regarding these transactions.

In November 2007, we issued $200 million of 2.625% Convertible Senior Notes maturing on December 1, 2014. On February 10, 2011, we announced the commencement of a tender offer to purchase for cash any and all of our outstanding 2014 Notes. Upon expiration on March 11, 2011, we purchased $170.9 million aggregate principal amount of the 2014 Notes. On August 22, 2012, we purchased $25.3 million aggregate principal amount of the 2014 Notes. As of December 31, 2012, $3.8 million aggregate principal amount of the 2014 Notes remain outstanding.

On February 10, 2011, we entered into a Senior Credit Facility. In March 2011, to fund the purchase of the 2014 Notes, we borrowed $150 million under the Term Loan facility available under our Senior Credit Facility. The Term Loan bears interest at a one month LIBOR, plus a margin based on our consolidated leverage ratio as defined in the Senior Credit Facility. On August 22, 2012, we used $130 million of proceeds from the issuance of the 2017 Notes to repay the Term Loan and terminated our Senior Credit Facility.

In March 2011, we entered into an interest rate swap agreement with a notional amount of $50 million, which we designated as a cash flow hedge of the underlying variable rate obligation on our Term Loan. The swap was terminated on August 22, 2012, and we paid approximately $1.8 million for the loss on the early termination.

As of December 31, 2012, we had an immaterial amount of cash and cash equivalents held in jurisdictions outside of the U.S., which are expected to be indefinitely reinvested for continued use in foreign operations. Repatriation of these assets to the U.S. would have negative tax consequences. We do not intend to repatriate these funds.

Table of Contents

Contractual Cash Obligations. At December 31, 2012, we had contractual cash obligations and commercial commitments as follows (in thousands):

| | Payments Due by Periods | | | | |
|---|---|---|---|---|---|
| | Total | 2013 | 2014-2015 | 2016-2017 | After 2017 |
| Amounts reflected in consolidated balance sheet: | | | | | |
| Lease obligations[1] | $830 | $811 | $19 | $— | $— |
| 2017 Convertible Senior Notes[2] | 300,000 | — | — | 300,000 | — |
| 2014 Convertible Senior Notes[3] | 3,768 | — | 3,768 | — | — |
| Amounts not reflected in consolidated balance sheet: | | | | | |
| Operating leases | 18,955 | 9,360 | 8,101 | 1,169 | 325 |
| Interest on 2017 Convertible Senior Notes[4] | 28,000 | 6,000 | 12,000 | 10,000 | — |
| Interest on 2014 Convertible Senior Notes[5] | 190 | 99 | 91 | — | — |
| Total contractual cash obligations | $351,743 | $16,270 | $23,979 | $311,169 | $325 |

(1) Payments include amounts representing interest.

(2) Represents long-term debt payment provided holders of the Convertible Senior Notes due 2017 do not exercise the option to convert each $1,000 note into 39.3140 shares of our common stock. Our Convertible Senior Notes are discussed further in Note 8 to our consolidated financial statements contained in “Financial Statements and Supplementary Data.”

(3) Represents long-term debt payment provided holders of the Convertible Senior Notes due 2014 do not exercise the option to convert each $1,000 note into 30.6279 shares of our common stock. Our Convertible Senior Notes are discussed further in Note 8 to our consolidated financial statements contained in “Financial Statements and Supplementary Data.”

(4) Represents interest on Convertible Senior Notes due 2017 payable semiannually with an annual interest rate of 2.000%.

(5) Represents interest on Convertible Senior Notes due 2014 payable semiannually with an annual interest rate of 2.625%.

The amounts reflected in the table above for capital lease obligations represent future minimum lease payments under our capital lease agreements, which are primarily for certain property and equipment. The present value of the minimum lease payments are recorded in our balance sheet at December 31, 2012. The minimum lease payments related to these leases are discussed further in Note 8 to our consolidated financial statements contained in “Financial Statements and Supplementary Data.”

The amounts reflected in the table above for operating leases represent future minimum lease payments under non-cancelable operating leases primarily for certain equipment and office space. Portions of these payments are denominated in foreign currencies and were translated in the table above based on their respective U.S. dollar exchange rates at December 31, 2012. These future payments are subject to foreign currency exchange rate risk. Our purchase obligations and royalty and consulting agreements are disclosed in Note 17 to our consolidated financial statements contained in “Financial Statements and Supplementary Data.”

Portions of these payments are denominated in foreign currencies and were translated in the table above based on their respective U.S. dollar exchange rates at December 31, 2012. These future payments are subject to foreign currency exchange rate risk. In accordance with U.S. generally accepted accounting principles, our operating leases are not recognized in our consolidated balance sheet; however, the minimum lease payments related to these agreements are disclosed in Note 17 to our consolidated financial statements contained in “Financial Statements and Supplementary Data.”

Contingent consideration of up to $400,000 may be paid related to the acquisition of certain assets associated with the EZ Concept Surgical Device Corporation (EZ Frame). The potential additional cash payments are based on the future financial performance of the acquired assets. Additionally, in accordance with the October 2011 CCI acquisition, we will pay royalties based on sales of the acquired product.

In addition to the contractual cash obligations discussed above, all of our U.S. sales and a portion of our international sales are subject to commissions based on net sales. A substantial portion of our global sales are subject to royalties earned based on product sales.

Additionally, as of December 31, 2012, we had $5.1 million of unrecognized tax benefits recorded within “Other liabilities” in our consolidated balance sheet. This represents the tax benefits associated with various tax positions taken, or expected to be taken, on U.S. and international tax returns that have not been recognized in our financial statements due to uncertainty regarding their resolution. We are unable to make a reliable estimate of the eventual cash flows by period that may be required to settle these matters. Certain of these matters may not require cash settlement due to the existence of net operating loss carryforwards. Therefore,

Table of Contents

our unrecognized tax benefits are not included in the table above. See Note 11 to our consolidated financial statements contained in “Financial Statements and Supplementary Data.”

Other Liquidity Information. We have funded our cash needs since 2000 through various equity and debt issuances and through cash flow from operations. Although it is difficult for us to predict our future liquidity requirements, we believe that our current cash balance of approximately $320.4 million and our marketable securities balance of $12.6 million will be sufficient for the foreseeable future to fund our working capital requirements and operations, permit anticipated capital expenditures in 2013 of approximately $30 million, and meet our contractual cash obligations in 2013, including the upfront cash payment of approximately $42 million upon the successful closing of our acquisition of BioMimetic.

Critical Accounting Estimates

All of our significant accounting policies and estimates are described in Note 2 to our consolidated financial statements contained in “Financial Statements and Supplementary Data.” Certain of our more critical accounting estimates require the application of significant judgment by management in selecting the appropriate assumptions in determining the estimate. By their nature, these judgments are subject to an inherent degree of uncertainty. We develop these judgments based on our historical experience, terms of existing contracts, our observance of trends in the industry, information provided by our customers and information available from other outside sources, as appropriate. Different, reasonable estimates could have been used in the current period. Additionally, changes in accounting estimates are reasonably likely to occur from period to period. Both of these factors could have a material impact on the presentation of our financial condition, changes in financial condition or results of operations.

We believe that the following financial estimates are both important to the portrayal of our financial condition and results of operations and require subjective or complex judgments. Further, we believe that the items discussed below are properly recorded in the financial statements for all periods presented. Our management has discussed the development, selection and disclosure of our most critical financial estimates with the audit committee of our board of directors and with our independent auditors. The judgments about those financial estimates are based on information available as of the date of the financial statements. Those financial estimates include:

Revenue recognition. Our revenues are primarily generated through two types of customers, hospitals and surgery centers and stocking distributors, with the majority of our revenue derived from sales to hospitals. Our products are sold through a network of employee and independent sales representatives in the U.S. and by a combination of employee sales representatives, independent sales representatives and stocking distributors outside the U.S. We record revenues from sales to hospitals and surgery centers when they take title to the product, which is generally when the product is surgically implanted in a patient.

We record revenues from sales to our stocking distributors at the time the product is shipped to the distributor. Our stocking distributors, who sell the products to their customers, take title to the products and assume all risks of ownership. Our distributors are obligated to pay us within specified terms regardless of when, if ever, they sell the products. In general, our distributors do not have any rights of return or exchange; however, in limited situations, we have repurchase agreements with certain stocking distributors. Those certain agreements require us to repurchase a specified percentage of the inventory purchased by the distributor within a specified period of time prior to the expiration of the contract. During those specified periods, we defer the applicable percentage of the sales. Approximately $0.1 million and $0.2 million of sales related to these types of agreements were deferred and not yet recognized as revenue as of December 31, 2012 and 2011, respectively.

We must make estimates of potential future product returns related to current period product revenue. To do so, we analyze our historical experience related to product returns when evaluating the adequacy of the allowance for sales returns. Judgment must be used and estimates made in connection with establishing the allowance for product returns in any accounting period. Our allowances for product returns of approximately $0.5 million and $0.5 million are included as a reduction of accounts receivable at December 31, 2012 and 2011, respectively. Should actual future returns vary significantly from our historical averages, our operating results could be affected.

In 2011, we entered into a trademark license agreement (License Agreement) with KCI Medical Resources, a subsidiary of Kinetic Concepts, Inc. (KCI). In exchange for $8.5 million, of which $5.5 million was received immediately and $3 million was received in January 2012, the License Agreement provides KCI with a

non-transferable license to use our trademarks associated with our GRAFTJACKET® line of products in connection with the marketing and distribution of KCI's soft tissue graft containment products used in the wound care field, subject to certain exceptions. License revenue is being recognized over 12 years on a straight line basis.

Allowances for doubtful accounts. We experience credit losses on our accounts receivable and accordingly, we must make estimates related to the ultimate collection of our accounts receivable. Specifically, we analyze our accounts receivable, historical bad debt experience, customer concentrations, customer creditworthiness and current economic trends when evaluating the adequacy of our allowance for doubtful accounts.

The majority of our accounts receivable are from hospitals, many of which are government funded. Accordingly, our collection history with this class of customer has been favorable. Historically, we have experienced minimal bad debts from our hospital

Table of Contents

customers and more significant bad debts from certain international stocking distributors, typically as a result of specific financial difficulty or geo-political factors. We write off accounts receivable when we determine that the accounts receivable are uncollectible, typically upon customer bankruptcy or the customer's non-response to continued collection efforts.

We believe that the amount included in our allowance for doubtful accounts has been a historically appropriate estimate of the amount of accounts receivable that are ultimately not collected. While we believe that our allowance for doubtful accounts is adequate, the financial condition of our customers and the geo-political factors that impact reimbursement under individual countries' healthcare systems can change rapidly, which would necessitate additional allowances in future periods. Our allowances for doubtful accounts were $8.6 million and $8.5 million, at December 31, 2012 and 2011, respectively.

Excess and obsolete inventories. We value our inventory at the lower of the actual cost to purchase and/or manufacture the inventory on a first-in, first-out (FIFO) basis or its net realizable value. We regularly review inventory quantities on hand for excess and obsolete inventory and, when circumstances indicate, we incur charges to write down inventories to their net realizable value. Our review of inventory for excess and obsolete quantities is based primarily on our forecast of product demand and production requirements for the next 24 months. A significant decrease in demand could result in an increase in the amount of excess inventory quantities on hand. Additionally, our industry is characterized by regular new product development that could result in an increase in the amount of obsolete inventory quantities on hand due to cannibalization of existing products. Also, our estimates of future product demand may prove to be inaccurate in which case we may be required to incur charges for excess and obsolete inventory. In the future, if additional inventory write-downs are required, we would recognize additional cost of goods sold at the time of such determination. Regardless of changes in our estimates of future product demand, we do not increase the value of our inventory above its adjusted cost basis. Therefore, although we make every effort to ensure the accuracy of our forecasts of future product demand, significant unanticipated decreases in demand or technological developments could have a significant impact on the value of our inventory and our reported operating results. Charges incurred for excess and obsolete inventory were $9.3 million, $16.7 million and $9.3 million for the years ended December 31, 2012, 2011 and 2010, respectively.

Goodwill and long-lived assets. We have approximately $58.1 million of goodwill recorded as a result of the acquisition of businesses. Goodwill is tested for impairment annually, or more frequently if changes in circumstances or the occurrence of events suggest that impairment exists. The annual evaluation of goodwill impairment may require the use of estimates and assumptions to determine the fair value of our reporting units using projections of future cash flows. Unless circumstances otherwise dictate, the annual impairment test is performed in the fourth quarter. As a result of our change in reportable segments during the first quarter of 2012, which also resulted in a change in reporting units for goodwill impairment measurement purposes, we performed a goodwill impairment analysis as of March 31, 2012. During the second quarter of 2012, we completed this goodwill impairment analysis and determined that the fair values of our reporting units exceeded their carrying values, indicating that goodwill had not been impaired. During the fourth quarter of 2012, we performed a qualitative assessment of goodwill for impairment and determined that it is more likely than not that the fair value of our OrthoRecon and Extremities reporting units exceeded their respective carrying values, indicating that goodwill was not impaired. As of December 31, 2012, there was goodwill of approximately $25.6 million and $32.3 million for our OrthoRecon and Extremities reporting units, respectively.

Our business is capital intensive, particularly as it relates to surgical instrumentation. We depreciate our property, plant and equipment and amortize our intangible assets based upon our estimate of the respective asset's useful life. Our estimate of the useful life of an asset requires us to make judgments about future events, such as product life cycles, new product development, product cannibalization and technological obsolescence, as well as other competitive factors beyond our control. We account for the impairment of finite, long-lived assets in accordance with the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Section 360, Property, Plant and Equipment (FASB ASC 360). Accordingly, we evaluate impairments of our property, plant and equipment based upon an analysis of estimated undiscounted future cash flows. If we determine that a change is required in the useful life of an asset, future depreciation and amortization is adjusted accordingly. Alternatively, if we determine that

an asset has been impaired, an adjustment would be charged to income based on the asset's fair market value, or discounted cash flows if the fair market value is not readily determinable, reducing income in that period.

Product liability claims, product liability insurance recoveries and other litigation. Periodically, claims arise involving the use of our products. We make provisions for claims specifically identified for which we believe the likelihood of an unfavorable outcome is probable and an estimate of the amount of loss has been developed. As additional information becomes available, we reassess the estimated liability related to our pending claims and make revisions as necessary.

In the third quarter of 2011, as a result of an increase in the number and monetary amount of claims associated with fractures of our long PROFEMUR® titanium modular necks ("PROFEMUR® Claims"), management recorded a provision for current and future claims associated with fractures of this product. See Note 17 to our consolidated financial statements for further description of this provision. Future revisions in our estimates of the liability could materially impact our results of operation and financial position. We maintain insurance coverage that limits the severity of any single claim as well as total amounts incurred per policy year, and we believe our insurance coverage is adequate. We use the best information available to us in determining the level of

Table of Contents

accrued product liabilities, and we believe our accruals are adequate. Our accrual for PROFEMUR® Claims was $23.3 million as of both December 31, 2012 and December 31, 2011. We maintain insurance coverage, and we have therefore recorded an estimate of the probable recovery of our accrual for PROFEMUR® Claims of approximately $11.4 million and $8.4 million related to open claims as of December 31, 2012 and December 31, 2011, respectively. Our accrual for other product liability claims was $0.6 million and $0.4 million at December 31, 2012 and December 31, 2011, respectively.

Claims for personal injury have also been made against us associated with our metal-on-metal hip products. We are currently accounting for these claims in accordance with our standard product liability accrual methodology on a case by case basis.

We have maintained product liability insurance coverage on a claims-made basis. See Note 17 to our consolidated financial statements for further description of our insurance coverage.

During the third quarter of 2012, we received a customary reservation of rights from our primary product liability insurance carrier asserting that certain present and future claims related to our CONSERVE® metal-on-metal hip products and which allege certain types of injury (hereafter "CONSERVE® Claims") would be covered under the policy year the first such claim was asserted. The effect of this coverage position would be to place CONSERVE® Claims into a single prior policy year in which applicable claims-made coverage was available, subject to the overall policy limits then in effect. Management agrees that there is insurance coverage for the CONSERVE® Claims, but has notified the carrier that at this time it disputes the carrier's selection of available policy years.

During the fourth quarter of 2012, we recorded a receivable of approximately $5.8 million for the probable insurance recovery of spending to date in excess of our aggregate retention in certain claim years. This spending primarily relates to defense and settlement costs associated with PROFEMUR® Claims and defense costs associated with CONSERVE® Claims. If our primary carrier were to assert that PROFEMUR® Claims fall under the policy year the first such claim was made, i.e., the same position as has been asserted for CONSERVE® Claims, then we would expect to recognize an additional insurance receivable and recover certain previously recorded defense and settlement costs.

We are also involved in legal proceedings involving contract, patent protection and other matters. We make provisions for claims specifically identified for which we believe the likelihood of an unfavorable outcome is probable and an estimate of the amount of loss can be developed.

Accounting for income taxes. Our effective tax rate is based on income by tax jurisdiction, statutory rates and tax saving initiatives available to us in the various jurisdictions in which we operate. Significant judgment is required in determining our effective tax rate and evaluating our tax positions. This process includes assessing temporary differences resulting from differing recognition of items for income tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. Realization of deferred tax assets in each taxable jurisdiction is dependent on our ability to generate future taxable income sufficient to realize the benefits. Management evaluates deferred tax assets on an ongoing basis and provides valuation allowances to reduce net deferred tax assets to the amount that is more likely than not to be realized.

Our valuation allowance balances totaled $14.2 million and $14.3 million as of December 31, 2012 and 2011, respectively, due to uncertainties related to our ability to realize, before expiration, some of our deferred tax assets for both U.S. and foreign income tax purposes. These deferred tax assets primarily consist of the carryforward of certain tax basis net operating losses and general business tax credits.

In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), effective January 1, 2007, which requires the tax effects of an income tax position to be recognized only if they are "more-likely-than-not" to be sustained based solely on the technical merits as of the reporting date. Effective July 1, 2009, this standard was incorporated into FASB ASC Section 740, Income Taxes. As a multinational corporation, we are subject to taxation in many jurisdictions and the calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax laws and regulations in various taxing jurisdictions. If we ultimately determine that the payment of these liabilities will be unnecessary, we will reverse the liability and recognize a tax benefit in the period in which we determine the liability no longer applies. Conversely, we record additional tax charges in a period in which we determine that a recorded tax liability is less than we expect the ultimate assessment

to be. Our liability for unrecognized tax benefits totaled $5.1 million and $3.7 million as of December 31, 2012 and 2011, respectively. See Note 11 to our consolidated financial statements contained in “Financial Statements and Supplementary Data” for further discussion of our unrecognized tax benefits.

We operate within numerous taxing jurisdictions. We are subject to regulatory review or audit in virtually all of those jurisdictions, and those reviews and audits may require extended periods of time to resolve. Management makes use of all available information and makes reasoned judgments regarding matters requiring interpretation in establishing tax expense, liabilities and reserves. We believe adequate provisions exist for income taxes for all periods and jurisdictions subject to review or audit.

Stock-based compensation. We calculate the grant date fair value of non-vested shares as the closing sales price on the trading day immediately prior to the grant date. We use the Black-Scholes option pricing model to determine the fair value of stock options and employee stock purchase plan shares. The determination of the fair value of these stock-based payment awards on the date

Table of Contents

of grant using an option-pricing model is affected by our stock price as well as assumptions regarding a number of complex and subjective variables, which include the expected life of the award, the expected stock price volatility over the expected life of the awards, expected dividend yield and risk-free interest rate.

We estimate the expected life of options evaluating the historical activity as required by FASB ASC Topic 718, Compensation — Stock Compensation. We estimate the expected stock price volatility based upon historical volatility of our common stock. The risk-free interest rate is determined using U.S. Treasury rates where the term is consistent with the expected life of the stock options. Expected dividend yield is not considered as we have never paid dividends and have no plans of doing so in the future.

The Black-Scholes option-pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable, characteristics not present in our option grants and employee stock purchase plan shares. Existing valuation models, including the Black-Scholes and lattice binomial models, may not provide reliable measures of the fair values of our stock-based compensation. Consequently, there is a risk that our estimates of the fair values of our stock-based compensation awards on the grant dates may bear little resemblance to the actual values realized upon the exercise, expiration, early termination or forfeiture of those stock-based payments in the future. Certain stock-based payments, such as employee stock options, may expire worthless or otherwise result in zero intrinsic value as compared to the fair values originally estimated on the grant date and reported in our financial statements. Alternatively, value may be realized from these instruments that is significantly higher than the fair values originally estimated on the grant date and reported in our financial statements. There is not currently a market-based mechanism or other practical application to verify the reliability and accuracy of the estimates stemming from these valuation models.

We are required to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. We use historical data to estimate pre-vesting forfeitures and record stock-based compensation expense only for those awards that are expected to vest. All stock-based awards are amortized on a straight-line basis over their respective requisite service periods, which are generally the vesting periods.

If factors change and we employ different assumptions for estimating stock-based compensation expense in future periods, such stock-based compensation expense in future periods may differ significantly from what we have recorded in the current period and could materially affect our operating income, net income and net income per share. A change in assumptions may also result in a lack of comparability with other companies that use different models, methods and assumptions.

See Note 14 to our consolidated financial statements contained in “Financial Statements and Supplementary Data” for further information regarding our stock-based compensation disclosures.

Acquisition method accounting. In accordance with FASB ASC Section 805, Business Combinations (FASB ASC 805), an acquiring entity is required to recognize all assets acquired and liabilities assumed at the acquisition date fair value. Legal fees and other transaction-related costs are expensed as incurred and are no longer included in goodwill as a cost of acquiring the business. FASB ASC 805 also requires acquirers, among other things, to estimate the acquisition-date fair value of any contingent consideration and to recognize any subsequent changes in the fair value of contingent consideration in earnings. In addition, restructuring costs the acquirer expects, but is not obligated to incur, will be recognized separately from the business acquisition.

Restructuring charges. We evaluate impairment issues for long-lived assets under the provisions of FASB ASC 360. We record severance-related expenses once they are both probable and estimable in accordance with the provisions of FASB ASC Section 712, Compensation-Nonretirement Postemployment Benefits, for severance provided under an ongoing benefit arrangement. One-time termination benefit arrangements and other costs associated with exit activities are accounted for under the provisions of FASB ASC Section 420, Exit or Disposal Cost Obligations. We estimated the expense for our restructuring initiatives by accumulating detailed estimates of costs, including the estimated costs of employee severance and related termination benefits, impairment of property, plant and equipment, contract termination payments for leases and any other qualifying exit costs. Such costs represented management’s best estimates, which were evaluated periodically to determine if an adjustment was required. See Note 16 to our consolidated financial statements contained in “Financial Statements and Supplementary Data” for further information

regarding our restructuring disclosures.

Table of Contents

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

Interest Rate Risk

Our exposure to interest rate risk arises principally from the interest rates associated with our invested cash balances. On December 31, 2012, we have invested short term cash and cash equivalents and marketable securities of approximately $220.6 million. We believe that a 10 basis point change in interest rates is reasonably possible in the near term. Based on our current level of investment, an increase or decrease of 10 basis points in interest rates would have an annual impact of approximately $220,000 to our interest income.

Equity Price Risk

Our 2017 Convertible Notes includes conversion and settlement provisions that are based on the price of our common stock at conversion or at maturity of the notes. In addition, the hedges and warrants associated with these convertible notes also include settlement provisions that are based on the price of our common stock. The amount of cash we may be required to pay, or the number of shares we may be required to provide to note holders at conversion or maturity of these notes, is determined by the price of our common stock. The amount of cash that we may receive from hedge counterparties in connection with the related hedges and the number of shares that we may be required to provide warrant counterparties in connection with the related warrants are also determined by the price of our common stock. Upon the expiration of our warrants, we will issue shares of common stock to the purchasers of the warrants to the extent our stock price exceeds the warrant strike price of $29.925 at that time. The following table shows the number of shares that we would issue to warrant counterparties at expiration of the warrants assuming various closing stock prices on the date of warrant expiration:

| Stock Price | | Shares (in thousands) |
|---|---|---|
| $32.92 | (10% greater than strike price) | 1,072 |
| $35.91 | (20% greater than strike price) | 1,966 |
| $38.90 | (30% greater than strike price) | 2,722 |
| $41.90 | (40% greater than strike price) | 3,370 |
| $44.89 | (50% greater than strike price) | 3,931 |

Foreign Currency Exchange Rate Fluctuations

Fluctuations in the rate of exchange between the U.S. dollar and foreign currencies could adversely affect our financial results. Approximately 30% and 31% of our total net sales were denominated in foreign currencies during the years ended December 31, 2012 and 2011, respectively, and we expect that foreign currencies will continue to represent a similarly significant percentage of our net sales in the future. Cost of sales related to these sales are primarily denominated in U.S. dollars; however, operating costs related to these sales are largely denominated in the same respective currencies, thereby partially limiting our transaction risk exposure. For sales not denominated in U.S. dollars, an increase in the rate at which a foreign currency is exchanged for U.S. dollars will require more of the foreign currency to equal a specified amount of U.S. dollars than before the rate increase. In such cases, if we price our products in the foreign currency, we will receive less in U.S. dollars than we did before the rate increase went into effect. If we price our products in U.S. dollars and our competitors price their products in local currency, an increase in the relative strength of the U.S. dollar could result in our prices not being competitive in a market where business is transacted in the local currency.

A substantial majority of our sales denominated in foreign currencies are derived from European Union countries, which are denominated in the euro; from Japan, which are denominated in the Japanese yen; from the United Kingdom, which are denominated in the British pound; and from Canada, which are denominated in the Canadian dollar. Additionally, we have significant intercompany receivables from our foreign subsidiaries which are denominated in foreign currencies, principally the euro, the yen, the British pound, and the Canadian dollar. Our principal exchange rate risk, therefore, exists between the U.S. dollar and the euro, the U.S. dollar and the yen, the U.S. dollar and the British pound, and the U.S. dollar and the Canadian dollar. Fluctuations from the beginning to the end of any given reporting period result in the revaluation of our foreign currency-denominated intercompany receivables and payables, generating currency translation gains or losses that impact our non-operating income and expense levels in the respective period.

As discussed in Note 2 to our consolidated financial statements in “Financial Statements and Supplementary Data,” we enter into certain short-term derivative financial instruments in the form of foreign currency forward contracts. These forward contracts are designed to mitigate our exposure to currency fluctuations in our intercompany balances denominated in euros, Japanese yen, British pounds and Canadian dollars. Any change in the fair value of these forward contracts as a result of a fluctuation in a currency exchange rate is expected to be offset by a change in the value of the intercompany balance. These contracts are effectively closed at the end of each reporting period.

Table of Contents

A uniform 10% strengthening in the value of the U. S. dollar relative to the currencies in which our transactions are denominated would have resulted in a decrease in operating income of approximately $8.0 million for the year ended December 31, 2012. This hypothetical calculation assumes that each exchange rate would change in the same direction relative to the U.S. dollar. This sensitivity analysis of the effects of changes in foreign currency exchange rates does not factor in a potential change in sales levels or local currency prices, which can be also be affected by the change in exchange rates.

Other

We do not purchase or hold any market risk instruments for trading purposes.

Table of Contents

Item 8. Financial Statements and Supplementary Data.

Wright Medical Group, Inc.
Consolidated Financial Statements
for the Years Ended December 31, 2012, 2011 and 2010
Index to Financial Statements

Table of Contents

Report of Independent Registered Public Accounting Firm
The Board of Directors and Stockholders

Wright Medical Group, Inc.:

We have audited the accompanying consolidated balance sheets of Wright Medical Group, Inc. and subsidiaries (the Company) as of December 31, 2012 and 2011, and the related consolidated statements of operations, changes in stockholders' equity, comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2012. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these
consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2012 and 2011, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2012, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 21, 2013 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial
reporting.
(signed) KPMG LLP
Memphis, Tennessee
February 21, 2013

Table of Contents

Report of Independent Registered Public Accounting Firm
The Board of Directors and Stockholders

Wright Medical Group, Inc.:

We have audited the effectiveness of internal control over financial reporting of Wright Medical Group, Inc. and subsidiaries(the Company) as of December 31, 2012, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control–Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company as of December 31, 2012 and 2011, and the related consolidated statements of operations, changes in stockholders' equity, comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2012, and our report dated February 21, 2013 expressed an unqualified opinion on those consolidated financial
statements.

(signed) KPMG LLP

Memphis, Tennessee
February 21, 2013

Table of Contents

Wright Medical Group, Inc.
Consolidated Balance Sheets
(In thousands, except share data)

| | December 31, 2012 | December 31, 2011 |
|---|---|---|
| Assets: | | |
| Current assets: | | |
| Cash and cash equivalents | $320,360 | $153,642 |
| Marketable securities | 12,646 | 13,597 |
| Accounts receivable, net | 98,636 | 98,995 |
| Inventories | 144,250 | 164,600 |
| Prepaid expenses | 16,090 | 5,916 |
| Deferred income taxes | 30,429 | 40,756 |
| Other current assets | 29,734 | 23,027 |
| Total current assets | 652,145 | 500,533 |
| Property, plant and equipment, net | 138,242 | 160,284 |
| Goodwill | 58,066 | 57,920 |
| Intangible assets, net | 21,294 | 17,731 |
| Marketable securities | — | 4,502 |
| Deferred income taxes | 3,167 | 3,688 |
| Other assets | 80,539 | 9,922 |
| Total assets | $953,453 | $754,580 |
| Liabilities and Stockholders' Equity: | | |
| Current liabilities: | | |
| Accounts payable | $10,342 | $11,651 |
| Accrued expenses and other current liabilities | 65,304 | 55,831 |
| Current portion of long-term obligations | 786 | 8,508 |
| Total current liabilities | 76,432 | 75,990 |
| Long-term debt and capital lease obligations | 258,504 | 166,792 |
| Deferred income taxes | 8,152 | 11,589 |
| Other liabilities | 86,924 | 31,745 |
| Total liabilities | 430,012 | 286,116 |
| Commitments and contingencies (Note 17) | | |
| Stockholders' equity: | | |
| Common stock, $.01 par value, authorized: 100,000,000 shares; issued and outstanding: 39,703,358 shares at December 31, 2012 and 39,306,118 shares at December 31, 2011 | 389 | 384 |
| Additional paid-in capital | 442,055 | 395,840 |
| Accumulated other comprehensive income | 22,534 | 19,061 |
| Retained earnings | 58,463 | 53,179 |
| Total stockholders' equity | 523,441 | 468,464 |
| Total liabilities and stockholders' equity | $953,453 | $754,580 |

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

Wright Medical Group, Inc.
Consolidated Statements of Operations
(In thousands, except per share data)

| | Year ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Net sales | $483,776 | $512,947 | $518,973 |
| Cost of sales [1] | 149,978 | 156,906 | 158,456 |
| Cost of sales - restructuring | 435 | 2,471 | — |
| Gross profit | 333,363 | 353,570 | 360,517 |
| Operating expenses: | | | |
| Selling, general and administrative [1] | 290,261 | 301,588 | 282,413 |
| Research and development [1] | 27,033 | 30,114 | 37,300 |
| Amortization of intangible assets | 5,772 | 2,870 | 2,711 |
| Gain on sale of intellectual property | (15,000) | — | — |
| Restructuring charges (Note 16) | 1,153 | 14,405 | 919 |
| Total operating expenses | 309,219 | 348,977 | 323,343 |
| Operating income | 24,144 | 4,593 | 37,174 |
| Interest expense, net | 10,188 | 6,529 | 6,123 |
| Other expense, net | 5,395 | 4,719 | 130 |
| Income (loss) before income taxes | 8,561 | (6,655) | 30,921 |
| Provision (benefit) for income taxes | 3,277 | (1,512) | 13,080 |
| Net income (loss) | $5,284 | $(5,143) | $17,841 |
| Net income (loss) per share (Note 12): | | | |
| Basic | $0.14 | $(0.13) | $0.47 |
| Diluted | $0.14 | $(0.13) | $0.47 |
| Weighted-average number of shares outstanding-basic | 38,769 | 38,279 | 37,802 |
| Weighted-average number of shares outstanding-diluted | 39,086 | 38,279 | 37,961 |

[1] These line items include the following amounts of non-cash, stock-based compensation expense for the periods indicated:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Cost of sales | $1,401 | $1,412 | $1,301 |
| Selling, general and administrative | 8,898 | 7,028 | 9,924 |
| Research and development | 675 | 668 | 1,952 |

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

WRIGHT MEDICAL GROUP, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands)

| | Year ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Net income (loss) | $5,284 | $(5,143) | $17,841 |
| Other comprehensive income (loss), net of tax: | | | |
| Changes in foreign currency translation | (1,301) | (2,102) | (826) |
| Unrealized loss on derivative instruments, net of taxes $42 and $600, respectively | (65) | (1,014) | — |
| Termination of interest rate swap, net of taxes of $690 | 1,079 | — | — |
| Unrealized gain (loss) on marketable securities, net of taxes $2,054, $21, and $48, respectively | 3,210 | (33) | 75 |
| Minimum pension liability adjustment | 550 | 37 | 18 |
| Other comprehensive income (loss) | 3,473 | (3,112) | (733) |
| Comprehensive income (loss) | $8,757 | $(8,255) | $17,108 |

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

Wright Medical Group, Inc.
Consolidated Statements of Cash Flows
(In thousands)

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Operating activities: | | | |
| Net income (loss) | $5,284 | $(5,143) | $17,841 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation | 38,275 | 40,227 | 35,559 |
| Stock-based compensation expense | 10,974 | 9,108 | 13,177 |
| Amortization of intangible assets | 5,772 | 2,870 | 2,711 |
| Amortization of deferred financing costs and debt discount | 3,853 | 982 | 1,060 |
| Deferred income taxes | 3,786 | (6,969) | 9,244 |
| Write off of deferred financing costs | 2,721 | 2,926 | — |
| Excess tax benefit from stock-based compensation arrangements | (507) | (23) | (289) |
| Provision for losses on accounts receivable | — | (453) | 1,073 |
| Non-cash restructuring charges | 657 | 4,924 | 246 |
| Non-cash adjustment to derivative fair value | 1,142 | — | — |
| Gain on sale of intellectual property | (15,000) | — | — |
| Other | 2,232 | 1,102 | 624 |
| Changes in assets and liabilities (net of acquisitions): | | | |
| Accounts receivable | (717) | 9,056 | (4,666) |
| Inventories | 20,622 | (1,723) | (1,754) |
| Prepaid expenses and other current assets | (15,498) | (10,556) | (5,094) |
| Accounts payable | (1,315) | (6,398) | 1,970 |
| Accrued expenses and other liabilities | 6,541 | 21,511 | 1,492 |
| Net cash provided by operating activities | 68,822 | 61,441 | 73,194 |
| Investing activities: | | | |
| Capital expenditures | (19,323) | (46,957) | (49,038) |
| Acquisition of businesses | — | (5,639) | (2,923) |
| Purchase of intangible assets | (4,112) | (1,624) | (1,690) |
| Maturities of held-to-maturity marketable securities | — | 4,748 | — |
| Investment in held-to-maturity marketable securities | — | — | (4,671) |
| Sales and maturities of available-for-sale marketable securities | 13,565 | 38,509 | 135,219 |
| Investment in available-for-sale marketable securities | (2,878) | (25,097) | (81,070) |
| Proceeds from sale of assets | 11,700 | 5,500 | — |
| Net cash used in investing activities | (1,048) | (30,560) | (4,173) |
| Financing activities: | | | |
| Issuance of common stock | 1,944 | 540 | 663 |
| Payments of long term borrowings | (144,375) | (5,596) | — |
| Proceeds from sale of warrants | 34,595 | — | — |
| Payment for bond hedge options | (56,195) | — | — |
| Redemption of 2014 convertible senior notes | (25,343) | (170,889) | — |
| Proceeds from long term borrowings | — | 150,000 | — |
| Payments of deferred financing costs and equity issuance costs | (9,637) | (2,892) | (795) |
| Proceeds from 2017 convertible senior notes | 300,000 | — | — |
| Payment for loss on interest rate swap termination | (1,769) | — | — |

| | | | |
|---|---|---|---|
| Payments of capital leases | (1,006) | (1,236) | (355) |
| Excess tax benefit from stock-based compensation arrangements | 507 | 23 | 289 |
| Net cash provided by (used in) financing activities | 98,721 | (30,050) | (198) |
| Effect of exchange rates on cash and cash equivalents | 223 | (450) | 29 |
| Net increase in cash and cash equivalents | 166,718 | 381 | 68,852 |
| Cash and cash equivalents, beginning of year | 153,642 | 153,261 | 84,409 |
| Cash and cash equivalents, end of year | $320,360 | $153,642 | $153,261 |

Table of Contents

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

Wright Medical Group, Inc.
Consolidated Statements of Changes in Stockholders' Equity
For the Years Ended December 31, 2010, 2011 and 2012
(In thousands, except share data)

| | Common Stock, Voting | | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Income | Total Stockholders' Equity |
|---|---|---|---|---|---|---|
| | Number of Shares | Amount | | | | |
| Balance at December 31, 2009 | 38,668,882 | $374 | $376,647 | $40,481 | $ 22,906 | $ 440,408 |
| 2010 Activity: | | | | | | |
| Net income | — | — | — | 17,841 | — | 17,841 |
| Foreign currency translation | — | — | — | — | (826) | (826) |
| Unrealized gain (loss) on marketable securities, net of taxes $48 | — | — | — | — | 75 | 75 |
| Minimum pension liability adjustment | — | — | — | — | 18 | 18 |
| Issuances of common stock | 79,976 | 1 | 662 | — | — | 663 |
| Grant of non-vested shares of common stock | 504,999 | — | — | — | — | — |
| Forfeitures of non-vested shares of common stock | (110,540) | — | — | — | — | — |
| Vesting of stock-settled phantom stock units and non-vested shares of common stock | 28,184 | 4 | (4) | — | — | — |
| Tax deficits realized from stock based compensation arrangements, net | — | — | (424) | — | — | (424) |
| Stock-based compensation | — | — | 13,217 | — | — | 13,217 |
| Balance at December 31, 2010 | 39,171,501 | $379 | $390,098 | $58,322 | $ 22,173 | $ 470,972 |
| 2011 Activity: | | | | | | |
| Net loss | — | — | — | (5,143) | — | (5,143) |
| Foreign currency translation | — | — | — | — | (2,102) | (2,102) |
| Unrealized loss on derivative instruments, net of taxes $0.6 | — | — | — | — | (1,014) | (1,014) |
| Unrealized gain (loss) on marketable securities, net of taxes $21 | — | — | — | — | (33) | (33) |
| Minimum pension liability adjustment | — | — | — | — | 37 | 37 |
| Issuances of common stock | 45,518 | 1 | 539 | — | — | 540 |
| Grant of non-vested shares of common stock | 403,084 | — | — | — | — | — |
| Forfeitures of non-vested shares of common stock | (354,774) | — | — | — | — | — |
| Vesting of stock-settled phantom stock units and | 40,789 | 4 | (4) | — | — | — |

| | | | | | | |
|---|---|---|---|---|---|---|
| non-vested shares of common stock | | | | | | |
| Tax deficits realized from stock based compensation arrangements, net | — | — | (3,869) | — | — | (3,869) |
| Stock-based compensation | — | $— | $9,076 | $— | $ — | $ 9,076 |
| Balance at December 31, 2011 | 39,306,118 | $384 | $395,840 | $53,179 | $ 19,061 | $ 468,464 |

Table of Contents

Wright Medical Group, Inc.
Consolidated Statements of Changes in Stockholders' Equity (Continued)
For the Years Ended December 31, 2010, 2011 and 2012
(In thousands, except share data)

| | Common Stock, Voting | | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Income | Total Stockholders' Equity |
|---|---|---|---|---|---|---|
| | Number of Shares | Amount | | | | |
| 2012 Activity: | | | | | | |
| Net income | — | — | — | 5,284 | — | 5,284 |
| Foreign currency translation | — | — | — | — | (1,301) | (1,301) |
| Unrealized loss on derivative instruments, net of $42 taxes | — | — | — | — | (65) | (65) |
| Loss on early termination of interest rate swap, net of taxes of $690 | — | — | — | — | 1,079 | 1,079 |
| Unrealized gain (loss) on marketable securities, net of taxes $2,054 | — | — | — | — | 3,210 | 3,210 |
| Minimum pension liability adjustment | — | — | — | — | 550 | 550 |
| Issuances of common stock | 113,470 | 1 | 1,948 | — | — | 1,949 |
| Grant of non-vested shares of common stock | 269,535 | — | — | — | — | — |
| Forfeitures of non-vested shares of common stock | (32,797) | — | — | — | — | — |
| Vesting of stock-settled phantom stock units and non-vested shares of common stock | 47,032 | 4 | (4) | — | — | — |
| Tax deficits realized from stock based compensation arrangements, net | — | — | (116) | — | — | (116) |
| Stock-based compensation | — | — | 10,932 | — | — | 10,932 |
| Equity issuance costs associated with pending acquisition (See Note 6) | — | — | (290) | — | — | (290) |
| Issuance of stock warrants, net of equity issuance costs (see Note 8) | — | — | 33,745 | — | — | 33,745 |
| Balance at December 31, 2012 | 39,703,358 | $389 | $442,055 | $58,463 | $ 22,534 | $ 523,441 |

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Description of Business

Wright Medical Group, Inc., through Wright Medical Technology, Inc. and other operating subsidiaries (Wright or we), is a global orthopaedic medical device company specializing in the design, manufacture and marketing of devices and biologic products for extremity, hip and knee repair and reconstruction. We are a leading provider of surgical solutions for the foot and ankle market. Our products are sold primarily through a network of employee sales representatives and independent sales representatives in the United States (U.S.) and by a combination of employee sales representatives, independent sales representatives and stocking distributors outside the U.S. We promote our products in approximately 60 countries with principal markets in the U.S., Europe, Canada, Australia and Japan. We are headquartered in Arlington, Tennessee.

2. Summary of Significant Accounting Policies

Principles of Consolidation. The accompanying consolidated financial statements include our accounts and those of our wholly owned U.S. and international subsidiaries. Intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates. The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The most significant areas requiring the use of management estimates relate to revenue recognition, the determination of allowances for doubtful accounts and excess and obsolete inventories, the evaluation of goodwill and long-lived assets, product liability claims and other litigation, income taxes, stock-based compensation, accounting for business combinations, and accounting for restructuring charges.

Cash and Cash Equivalents. Cash and cash equivalents include all cash balances and short-term investments with original maturities of three months or less.

Inventories. Our inventories are valued at the lower of cost or market on a first-in, first-out (FIFO) basis. Inventory costs include material, labor costs and manufacturing overhead. We regularly review inventory quantities on hand for excess and obsolete inventory and, when circumstances indicate, we incur charges to write down inventories to their net realizable value. Our review of inventory for excess and obsolete quantities is based primarily on our estimated forecast of product demand and production requirements for the next twenty-four months. Charges incurred to write down excess and obsolete inventory to net realizable value included in “Cost of sales” were approximately $9.3 million, $16.7 million, and $9.3 million for the years ended December 31, 2012, 2011, and 2010, respectively.

Additionally, in 2012 and 2011, we recorded charges of approximately $0.4 million and $2.5 million associated with the cost restructuring announced in the third quarter of 2011 for the reduction of the size of our international product portfolio.

Product Liability Claims, Product Liability Insurance Recoveries, and Other Litigation. In the third quarter of 2011, as a result of an increase in the number of claims associated with fractures of our long PROFEMUR® titanium modular necks in North America (PROFEMUR® Claims) and an increase in the monetary amount of those claims, management recorded a provision for current and future claims associated with fractures of this product. See Note 17 for further description of this provision.

Future revisions in our estimates of these provisions could materially impact our results of operations and financial position. We maintain insurance coverage that limits the severity of any single claim as well as total amounts incurred per policy year, and we believe our insurance coverage is adequate. We use the best information available to us in determining the level of accrued product liabilities, and we believe our accruals are adequate.

We are also involved in legal proceedings involving other product liability claims as well as contract, patent protection and other matters. We make provisions for claims specifically identified for which we believe the likelihood of an unfavorable outcome is probable and an estimate of the amount of loss can be estimated. We have

recorded at least the minimum estimated liability related to those claims where a range of loss has been established. Our accrual for PROFEMUR® Claims was $23.3 million as of both December 31, 2012 and December 31, 2011. We maintain insurance coverage, and we have therefore recorded an estimate of the probable recovery of our accrual for PROFEMUR® Claims of approximately $11.4 million and $8.4 million related to open claims as of December 31, 2012 and December 31, 2011, respectively. Our accrual for other product liability claims was $0.6 million and $0.4 million as of December 31, 2012 and December 31, 2011, respectively. We recognize legal fees as an expense in the period incurred.

Table of Contents

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

Property, Plant and Equipment. Our property, plant and equipment is stated at cost. Depreciation, which includes amortization of assets under capital lease, is generally provided on a straight-line basis over the estimated useful lives generally based on the following categories:

| | | | | |
|---|---|---|---|---|
| Land improvements | 15 | to | 25 | years |
| Buildings | 10 | to | 45 | years |
| Machinery and equipment | 3 | to | 14 | years |
| Furniture, fixtures and office equipment | 1 | to | 14 | years |
| Surgical instruments | | | 6 | years |

Expenditures for major renewals and betterments, including leasehold improvements, that extend the useful life of the assets are capitalized and depreciated over the remaining life of the asset or lease term, if shorter. Maintenance and repair costs are charged to expense as incurred. Upon sale or retirement, the asset cost and related accumulated depreciation are eliminated from the respective accounts and any resulting gain or loss is included in income.
Intangible Assets and Goodwill. Goodwill is recognized for the excess of the purchase price over the fair value of net assets of businesses acquired. Goodwill is required to be tested for impairment at least annually. Unless circumstances otherwise dictate, the annual impairment test is performed in the fourth quarter. As a result of our change in reportable segments during the first quarter of 2012, which also resulted in a change in reporting units for goodwill impairment measurement purposes, we performed a goodwill impairment analysis as of March 31, 2012. During the second quarter of 2012, we completed this goodwill impairment analysis and determined that the fair values of our reporting units exceeded their carrying values, indicating that goodwill had not been impaired. During the fourth quarter of 2012, we performed a qualitative assessment of goodwill for impairment and determined that it is more likely than not that the fair value of our reporting units exceeded their respective carrying values, indicating that goodwill was not impaired.
Our intangible assets with estimable useful lives are amortized on a straight line basis over their respective estimated useful lives to their estimated residual values. This method of amortization approximates the expected future cash flow generated from their use. Finite lived intangibles are reviewed for impairment in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Section 360, Property, Plant and Equipment (FASB ASC 360). The weighted average amortization periods for completed technology, distribution channels, trademarks, licenses, customer relationships, non-compete agreements and other intangible assets are 10 years, 6 years, 7 years, 13 years, 10 years, 3 years and 6 years, respectively. The weighted average amortization period of our intangible assets on a combined basis is 8 years. Additionally, we have three indefinite lived trademarks and one in-process research and development (IPRD) intangible asset. These indefinite lived intangible assets are not amortized, but are instead tested for impairment at least annually in accordance with the provisions of FASB ASC Section 350, Intangibles - Goodwill and Other.
Valuation of Long-Lived Assets. Management periodically evaluates carrying values of long-lived assets, including property, plant and equipment and intangible assets, when events and circumstances indicate that these assets may have been impaired. We account for the impairment of long-lived assets in accordance with FASB ASC 360. Accordingly, we evaluate impairment of our property, plant and equipment based upon an analysis of estimated undiscounted future cash flows. If it is determined that a change is required in the useful life of an asset, future depreciation and amortization is adjusted accordingly. Alternatively, should we determine that an asset is impaired, an adjustment would be charged to income based on the difference between the asset’s fair market value and the asset's carrying value.
Allowances for Doubtful Accounts. We experience credit losses on our accounts receivable and, accordingly, we must make estimates related to the ultimate collection of our accounts receivable. Specifically, management analyzes our

accounts receivable, historical bad debt experience, customer concentrations, customer credit-worthiness and current economic trends when evaluating the adequacy of our allowance for doubtful accounts.

The majority of our accounts receivable are from hospitals, many of which are government funded. Accordingly, our collection history with this class of customer has been favorable. Historically, we have experienced minimal bad debts from our hospital customers and more significant bad debts from certain international stocking distributors, typically as a result of specific financial difficulty or geo-political factors. We write off accounts receivable when we determine that the accounts receivable are uncollectible, typically upon customer bankruptcy or the customer's non-response to continued collection efforts. Our allowance for doubtful accounts totaled $8.6 million and $8.5 million at December 31, 2012 and 2011, respectively.

Concentration of Credit Risk. Financial instruments that potentially subject us to concentrations of credit risk consist principally of accounts receivable. Management attempts to minimize credit risk by reviewing customers' credit history before extending

Table of Contents

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

credit and by monitoring credit exposure on a regular basis. An allowance for possible losses on accounts receivable is established based upon factors surrounding the credit risk of specific customers, historical trends and other information. Collateral or other security is generally not required for accounts receivable. As of December 31, 2012 and 2011, the balance due from our stocking distributor in Turkey was $6.9 million and $6.8 million, respectively. As of December 31, 2012 and 2011, we have recorded an allowance for doubtful accounts of $6.4 million and $6.2 million, respectively, for potential losses related to the trade receivable.

In addition to the stocking distributor in Turkey, our next ten largest international stocking distributors have net trade receivable balances totaling approximately $15.7 million as of December 31, 2012. It is at least reasonably possible that changes in global economic conditions and/or local operating and economic conditions in the regions these distributors operate, or other factors, could affect the future realization of these accounts receivable balances.

Concentrations of Supply of Raw Material. We rely on a limited number of suppliers for the components used in our products. Our reconstructive joint devices are produced from various surgical grades of titanium, cobalt chrome, stainless steel, various grades of high density polyethylenes, and ceramics. We rely on one source to supply us with a certain grade of cobalt chrome alloy one supplier of ceramics, and one supplier of implantable polyethylenes. For certain human biologic products, we depend on one supplier of demineralized bone matrix (DBM) and cancellous bone matrix (CBM). We rely on one supplier for our GRAFTJACKET® family of soft tissue repair and graft containment products, and one supplier for our xenograph bone wedge product. Porcine biologic soft tissue graft, BIOTAPE® XM relies on a single source supplier as well. We maintain adequate stock from these suppliers in order to meet market demand. Additionally, on November 2, 2012, we sold our metal casting equipment, which was used to produce unfinished components of certain of our OrthoRecon products. In connection with the sale, we entered into a long-term supply agreement with the purchaser to be our sole source provider for those unfinished components.

Income Taxes. Income taxes are accounted for pursuant to the provisions of FASB ASC Section 740, Income Taxes (FASB ASC 740). Our effective tax rate is based on income by tax jurisdiction, statutory rates and tax saving initiatives available to us in the various jurisdictions in which we operate. Significant judgment is required in determining our effective tax rate and evaluating our tax positions. This process includes assessing temporary differences resulting from differing recognition of items for income tax and financial accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. The measurement of deferred tax assets is reduced by a valuation allowance if, based upon available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

We provide for unrecognized tax benefits based upon our assessment of whether a tax position is “more-likely-than-not” to be sustained upon examination by the tax authorities. If a tax position meets the more-likely-than-not standard, then the related tax benefit is measured based on a cumulative probability analysis of the amount that is more-likely-than-not to be realized upon ultimate settlement or disposition of the underlying tax position.

Other Taxes. Taxes assessed by a governmental authority that are imposed concurrent with our revenue transactions with customers are presented on a net basis in our consolidated statement of operations.

Revenue Recognition. Our revenues are primarily generated through two types of customers, hospitals and surgery centers, and stocking distributors, with the majority of our revenue derived from sales to hospitals. Our products are primarily sold through a network of employee sales representatives and independent sales representatives in the U.S. and by a combination of employee sales representatives, independent sales representatives, and stocking distributors outside the U.S. Revenues from sales to hospitals are recorded when the hospital takes title to the product, which is generally when the product is surgically implanted in a patient.

We record revenues from sales to our stocking distributors outside the U.S. at the time the product is shipped to the distributor. Stocking distributors, who sell the products to their customers, take title to the products and assume all risks of ownership. Our distributors are obligated to pay within specified terms regardless of when, if ever, they sell the products. In general, the distributors do not have any rights of return or exchange; however, in limited situations,

we have repurchase agreements with certain stocking distributors. Those certain agreements require us to repurchase a specified percentage of the inventory purchased by the distributor within a specified period of time prior to the expiration of the contract. During those specified periods, we defer the applicable percentage of the sales. Approximately $0.1 million and $0.2 million of deferred revenue related to these types of agreements was recorded at December 31, 2012 and 2011, respectively.

We must make estimates of potential future product returns related to current period product revenue. We develop these estimates by analyzing historical experience related to product returns. Judgment must be used and estimates made in connection with establishing the allowance for sales returns in any accounting period. An allowance for sales returns of $0.5 million is included as a reduction of accounts receivable at December 31, 2012 and 2011, respectively.

In 2011, we entered into a trademark license agreement (License Agreement) with KCI Medical Resources, a subsidiary of Kinetic Concepts, Inc. (KCI). In exchange for $8.5 million, of which $5.5 million was received immediately and the remaining $3 million

Table of Contents

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

was received in January 2012, the License Agreement provides KCI with a non-transferable license to use our trademarks associated with our GRAFTJACKET® line of products in connection with the marketing and distribution of KCI's soft tissue graft containment products used in the wound care field, subject to certain exceptions. License revenue is being recognized over 12 years on a straight line basis.

Shipping and Handling Costs. We incur shipping and handling costs associated with the shipment of goods to customers, independent distributors and our subsidiaries. Amounts billed to customers for shipping and handling of products are included in net sales. Costs incurred related to shipping and handling of products to customers are included in selling, general and administrative expenses. All other shipping and handling costs are included in cost of sales.

Research and Development Costs. Research and development costs are charged to expense as incurred.

Foreign Currency Translation. The financial statements of our international subsidiaries whose functional currency is the local currency are translated into U.S. dollars using the exchange rate at the balance sheet date for assets and liabilities and the weighted average exchange rate for the applicable period for revenues, expenses, gains and losses. Translation adjustments are recorded as a separate component of comprehensive income in stockholders' equity. Gains and losses resulting from transactions denominated in a currency other than the local functional currency are included in "Other expense, net" in our consolidated statement of operations.

Pension Benefits. Our subsidiary in Japan provides benefits to employees under a plan that we account for as a defined benefit plan in accordance with FASB ASC Section 715, Compensation — Retirement Benefits. This plan is unfunded and determining the minimum pension liability requires the use of assumptions and estimates, including discount rates and mortality rates, and actuarial methods. Our minimum pension liability totaled $1.7 million and $2.3 million as of December 31, 2012 and 2011, respectively.

Comprehensive Income. Comprehensive income is defined as the change in equity during a period related to transactions and other events and circumstances from non-owner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. The difference between our net income and our comprehensive income is attributable to foreign currency translation, unrealized gains and losses (net of taxes) on our derivative instrument, adjustments to our minimum pension liability, and unrealized gains and losses on our available-for-sale marketable securities. In accordance with FASB Accounting Standards Update 2011-05, Presentation of Comprehensive Income, we have changed our presentation of comprehensive income by including a separate Statement of Comprehensive Income.

Stock-Based Compensation. We account for stock-based compensation in accordance with FASB ASC Section 718, Compensation — Stock Compensation (FASB ASC 718). Under the fair value recognition provisions of FASB ASC 718, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense on a straight-line basis over the requisite service period, which is the vesting period. The determination of the fair value of stock-based payment awards, such as options, on the date of grant using an option-pricing model is affected by our stock price, as well as assumptions regarding a number of complex and subjective variables, which include the expected life of the award, the expected stock price volatility over the expected life of the awards, expected dividend yield and risk-free interest rate.

We recorded stock-based compensation expense of $11.0 million, $9.1 million, and $13.2 million during the years ended December 31, 2012, 2011 and 2010, respectively. See Note 14 for further information regarding our stock-based compensation assumptions and expenses.

Fair Value of Financial Instruments. The carrying value of cash and cash equivalents, accounts receivable and accounts payable approximates the fair value of these financial instruments at December 31, 2012 and 2011 due to their short maturities or variable rates.

The $3.8 million of our 2014 Notes are carried at cost. The estimated fair value of our 2014 Notes was approximately $3.7 million at December 31, 2012 based on a limited number of trades and does not necessarily represent the value at

which the entire 2014 Note portfolio can be retired.

The 300 million of our 2017 Notes are carried at cost. The estimated fair value of our 2017 Notes was approximately $321 million at December 31, 2012, which includes the conversion derivative described in Note 8 of the financial statements, based on a quoted price in an active market (Level 1).

FASB ASC Section 820, Fair Value Measurements and Disclosures requires fair value measurements be classified and disclosed in one of the following three categories:

Level 1: Financial instruments with unadjusted, quoted prices listed on active market exchanges.

Table of Contents

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

Level 2: Financial instruments determined using prices for recently traded financial instruments with similar underlying terms as well as directly or indirectly observable inputs, such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3: Financial instruments that are not actively traded on a market exchange. This category includes situations where there is little, if any, market activity for the financial instrument. The prices are determined using significant unobservable inputs or valuation techniques.

We use a third-party provider to determine fair values of our available-for-sale marketable securities. The third-party provider receives market prices for each marketable security from a variety of industry standard data providers, security master files from large financial institutions and other third-party sources with reasonable levels of price transparency. The third-party provider uses these multiple prices as inputs into a pricing model to determine a weighted average price for each security. We have controls in place to review the third party provider's qualifications and procedures used to determine fair values and to validate the prices used in their determination of fair value. We classify our corporate equity securities as Level 1 based upon quoted prices in active markets. All other marketable securities are classified as Level 2 based upon the other than quoted prices with observable market data. These include municipal debt securities, U.S. agency debt securities, and corporate debt securities.

The following table summarizes the valuation of our financial instruments (in thousands):

| | Total | Quoted Prices in Active Markets (Level 1) | Prices with Other Observable Inputs (Level 2) | Prices with Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| At December 31, 2012 | | | | |
| Assets | | | | |
| Cash and cash equivalents | $320,360 | $320,360 | $— | $ — |
| Available-for-sale marketable securities | | | | |
| U.S. agency debt securities | 2,500 | — | 2,500 | — |
| Corporate debt securities | 2,001 | — | 2,001 | — |
| Total debt securities | 4,501 | — | 4,501 | — |
| Corporate equity securities | 8,145 | 8,145 | — | — |
| Total available-for-sale marketable securities | 12,646 | 8,145 | 4,501 | — |
| 2017 Notes Hedges | 62,000 | — | — | 62,000 |
| Total | $395,006 | $328,505 | $4,501 | $ 62,000 |
| Liabilities | | | | |
| 2017 Notes Conversion Derivative | 55,000 | — | — | 55,000 |
| Contingent consideration | 983 | — | — | 983 |
| Total | $55,983 | $— | $— | $ 55,983 |

Table of Contents

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

| | Total | Quoted Prices in Active Markets (Level 1) | Prices with Other Observable Inputs (Level 2) | Prices with Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| At December 31, 2011 | | | | |
| Assets | | | | |
| Cash and cash equivalents | $153,642 | $153,642 | $— | $ — |
| Available-for-sale marketable securities | | | | |
| Municipal debt securities | 508 | — | 508 | — |
| U.S. agency debt securities | 2,498 | — | 2,498 | — |
| Corporate debt securities | 15,093 | — | 15,093 | — |
| Total available-for-sale marketable securities | 18,099 | — | 18,099 | — |
| Total | $171,741 | $153,642 | $18,099 | $ — |
| Liabilities | | | | |
| Interest rate swap | 1,662 | — | 1,662 | — |
| Contingent consideration | 1,704 | — | — | 1,704 |
| Total | $3,366 | $— | $1,662 | $ 1,704 |

As part of the acquisition of EZ Concepts Surgical Device Corporation, d/b/a EZ Frame, completed in 2010, we may be obligated to pay contingent consideration of up to $0.4 million upon the achievement of certain revenue milestones. The $0.4 million fair value of the contingent consideration as of December 31, 2012 was determined using a discounted cash flow model and probability adjusted estimates of the future earnings and is classified in Level 3. This obligation is included in current liabilities in our 2012 consolidated balance sheet. Changes in the fair value of contingent consideration are recorded in our consolidated statements of operations.

As part of the acquisition of CCI® Evolution Mobile Bearing Total Ankle Replacement system, completed in 2011, we recorded a contingent liability for royalty payments associated with future sales of this product. The $0.6 million fair value of the contingent consideration as of December 31, 2012 was determined using a discounted cash flow model and probability adjusted estimates of the future revenues and is classified in Level 3. An obligation of $0.1 million was recorded in current liabilities and an obligation of $0.5 million recorded in long term liabilities in our 2012 consolidated balance sheet. Changes in the fair value of contingent consideration will be recorded in our consolidated statements of operations.

During the third quarter of 2012, we issued $300 million of 2.00% Convertible Senior Notes. As a result, we have recorded a derivative liability for the conversion feature (2017 Notes Conversion Derivative). Additionally, we entered into convertible notes hedging transactions (2017 Notes Hedges) in connection with convertible note issuance. The 2017 Notes Hedges and the 2017 Notes Conversion Derivative are measured at fair value using Level 3 inputs. These instruments are not actively traded and are valued using an option pricing model that uses observable and unobservable market data for inputs, such as implied volatility of our common stock, risk-free interest rate and other factors.

The following is a roll forward of our assets and liabilities measured at fair value on a recurring basis using unobservable inputs (Level 3):

| | Balance at December 31, 2011 | Transfers into Level 3 | Gain/Losses included in | Balance at December 31, 2012 |
|---|---|---|---|---|

| | | | Earnings | |
|---|---|---|---|---|
| 2017 Notes Hedges | — | 56,195 | 5,805 | 62,000 |
| 2017 Notes Conversion Derivative | — | (48,053) | (6,947) | (55,000) |
| Contingent Consideration | (1,704) | — | 721 | (983) |

Table of Contents

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

Derivative Instruments. We account for derivative instruments and hedging activities under FASB ASC Section 815, Derivatives and Hedging (FASB ASC 815). Accordingly, all of our derivative instruments are recorded in the accompanying consolidated balance sheets as either an asset or liability and measured at fair value. The changes in the derivative's fair value are recognized currently in earnings unless specific hedge accounting criteria are met.

We employ a derivative program using 30-day foreign currency forward contracts to mitigate the risk of currency fluctuations on our intercompany receivable and payable balances that are denominated in foreign currencies. These forward contracts are expected to offset the transactional gains and losses on the related intercompany balances. These forward contracts are not designated as hedging instruments under FASB ASC 815. Accordingly, the changes in the fair value and the settlement of the contracts are recognized in the period incurred in the accompanying consolidated statements of operations.

We recorded a net loss of $0.4 million, $0.9 million and $2.6 million for the years ended December 31, 2012, 2011 and 2010, respectively, on foreign currency contracts, which are included in "Other (income) expense, net" in our consolidated statements of operations. These losses substantially offset translation gains recorded on our intercompany receivable and payable balances, also included in "Other (income) expense, net." At December 31, 2012 and 2011, we had no foreign currency contracts outstanding.

On August 31, 2012, we issued the 2017 Notes. The 2017 Notes Conversion Derivative requires bifurcation from the 2017 Notes in accordance with ASC Topic 815, and is accounted for as a derivative liability. We also entered into 2017 Notes Hedges in connection with the issuance of the 2017 Notes with three counterparties. The 2017 Notes Hedges, which are cash-settled, are intended to reduce our exposure to potential cash payments that we are required to make upon conversion of the 2017 Notes in excess of the principal amount of converted notes if our common stock price exceeds the conversion price. The 2017 Notes Hedges is accounted for as a derivative asset in accordance with ASC Topic 815.

Additionally, in 2011, we entered into an interest rate swap to hedge a portion of our variable interest rate obligations which was subsequently terminated in 2012. The interest rate swap has been accounted for as a cash flow hedge in accordance with FASB ASC Topic 815. See Note 10 for further disclosure on our derivative instruments.

Reclassifications. Certain prior year amounts in the notes to consolidated financial statements have been reclassified to conform to the current year presentation.

Supplemental Cash Flow Information. Cash paid for interest and income taxes was as follows (in thousands):

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Interest | $4,639 | $6,162 | $5,524 |
| Income taxes | $4,973 | $7,006 | $6,670 |

In 2012, we entered into no new capital leases. In 2011 and 2010, we entered into capital leases of approximately $0.2 million and $2.5 million, respectively.

3. Inventories

Inventories consist of the following (in thousands):

| | December 31, | |
|---|---|---|
| | 2012 | 2011 |
| Raw materials | $7,617 | $8,860 |
| Work-in-process | 14,316 | 19,363 |
| Finished goods | 122,317 | 136,377 |
| | $144,250 | $164,600 |

4. Marketable Securities

We have historically invested in treasury bills, government and agency bonds, and certificates of deposit with maturity dates of less than 12 months. Our investments in these marketable securities are classified as available-for-sale securities in accordance with FASB ASC Topic 320, Investments — Debt and Equity Securities. These securities are carried at their fair value, and all unrealized gains and losses are recorded within other comprehensive income. Marketable securities are classified as current for those expected to mature or be sold within 12 months and the remaining portion is classified as non-current. The cost of investment securities sold is determined by the specific identification method.

Table of Contents

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

As of December 31, 2012 and 2011, we had current marketable securities totaling $12.6 million and $13.6 million, respectively, consisting of investments in corporate, municipal and agency bonds and corporate equity securities, all of which are valued at fair value using a market approach. In addition, we had noncurrent marketable securities totaling $4.5 million as of December 31, 2011, consisting of investments in corporate, municipal, and agency bonds, all of which are valued at fair value using a market approach.

The following tables present a summary of our marketable securities (in thousands):

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized (Losses) | Estimated Fair Value |
|---|---|---|---|---|
| At December 31, 2012 | | | | |
| Available-for-sale marketable securities | | | | |
| U.S. agency debt securities | $2,500 | $— | $— | $2,500 |
| Corporate debt securities | 2,000 | 1 | — | 2,001 |
| Total debt securities | 4,500 | 1 | — | 4,501 |
| Corporate equity securities | 2,878 | 5,267 | — | 8,145 |
| Total available-for-sale marketable securities | $7,378 | $5,268 | $— | $12,646 |

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized (Losses) | Estimated Fair Value |
|---|---|---|---|---|
| At December 31, 2011 | | | | |
| Available-for-sale marketable securities | | | | |
| Municipal debt securities | $507 | $1 | $— | $508 |
| U.S. agency debt securities | 2,500 | — | (2) | 2,498 |
| Corporate debt securities | 15,089 | 4 | — | 15,093 |
| Total available-for-sale marketable securities | $18,096 | $5 | $(2) | $18,099 |

Our available-for-sale debt securities at December 31, 2012 mature in one year or less.

5. Property, Plant and Equipment

Property, plant and equipment, net consists of the following (in thousands):

| | December 31, | |
|---|---|---|
| | 2012 | 2011 |
| Land and land improvements | $5,190 | $5,628 |
| Buildings | 31,064 | 30,543 |
| Machinery and equipment | 75,615 | 74,878 |
| Furniture, fixtures and office equipment | 62,079 | 57,299 |
| Construction in progress | 7,044 | 7,553 |
| Surgical instruments | 171,005 | 177,104 |
| | 351,997 | 353,005 |
| Less: Accumulated depreciation | (213,755) | (192,721) |
| | $138,242 | $160,284 |

The components of property, plant and equipment recorded under capital leases consist of the following (in thousands):

| | December 31, | |
|---|---|---|
| | 2012 | 2011 |
| Machinery and equipment | $2,515 | $2,663 |
| Furniture, fixtures and office equipment | 318 | 639 |
| | 2,833 | 3,302 |
| Less: Accumulated depreciation | (644) | (593) |
| | $2,189 | $2,709 |

Table of Contents

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

Depreciation expense approximated $38.3 million, $40.2 million, and $35.6 million for the years ended December 31, 2012, 2011, and 2010, respectively, and included depreciation of assets under capital leases.

Table of Contents

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

6. Goodwill and Intangibles

Until December 31, 2011, we operated our business as one operating segment, orthopaedics products, and based on our single business unit approach to decision-making, planning and resource allocation, we determined that we had only one reporting unit for the purpose of evaluating goodwill for impairment.

During the first quarter of 2012, our management, including our chief executive officer, who is our chief operating decision maker, began managing our operations as two reportable business segments based on the two primary markets that we operate within: Extremities and OrthoRecon. As a result of the change in our reportable segments, we re-evaluated our reporting units for the purpose of evaluating goodwill for impairment and determined that each reportable segment represents a reporting unit.

The goodwill allocated to each reportable segment was based on the estimated relative fair value of each of our goodwill reporting units as of March 31, 2012.

Changes in the carrying amount of goodwill occurring during the year ended December 31, 2012, are as follows (in thousands):

| | OrthoRecon | Extremities | Total |
|---|---|---|---|
| Goodwill at December 31, 2011 | $25,588 | $32,332 | $57,920 |
| Foreign currency translation | 64 | 82 | 146 |
| Goodwill at December 31, 2012 | $25,652 | $32,414 | $58,066 |

The components of our identifiable intangible assets, net are as follows (in thousands):

| | December 31, 2012 | | December 31, 2011 | |
|---|---|---|---|---|
| | Cost | Accumulated Amortization | Cost | Accumulated Amortization |
| Indefinite life intangibles | | | | |
| IPRD technology | $278 | | $278 | |
| Trademarks | 1,658 | | 1,658 | |
| Total indefinite life intangibles | 1,936 | | 1,936 | |
| | | | | |
| Finite life intangibles | | | | |
| Distribution channels | 21,482 | $20,668 | 21,096 | $20,057 |
| Completed technology | 10,991 | 5,457 | 10,976 | 4,416 |
| Licenses | 5,705 | 2,898 | 5,721 | 2,478 |
| Customer relationships | 3,888 | 1,866 | 3,888 | 1,476 |
| Trademarks | 1,336 | 934 | 1,336 | 818 |
| Non-compete agreements | 10,955 | 3,994 | 1,734 | 832 |
| Other | 2,171 | 1,353 | 2,171 | 1,050 |
| Total finite life intangibles | 56,528 | $37,170 | 46,922 | $31,127 |
| | | | | |
| Total intangibles | 58,464 | | 48,858 | |
| Less: Accumulated amortization | (37,170) | | (31,127) | |
| Intangible assets, net | $21,294 | | $17,731 | |

In connection with our initiative to convert a portion of our independent foot and ankle distributor territories to direct employee sales representation, we entered into conversion agreements with certain independent distributors, which included non-competition clauses. As of December 31, 2012, $9.3 million has been capitalized as an intangible asset for the fair value of such non-competition clauses and will be amortized over the respective terms, of which the weighted average period is 2 years.

Based on the intangible assets held at December 31, 2012, we expect to amortize approximately $6.7 million in 2013, $4.1 million in 2014, $2.3 million in 2015, $2.0 million in 2016, and $1.6 million in 2017.

On November 19, 2012, we announced plans to purchase BioMimetic for an upfront purchase price payment of $190 million in cash and stock, plus contingent payments of up to $190 million in cash. As of September 30, 2012, BioMimetic had $57.1 million in total assets. The transaction is expected to close in the first quarter of 2013 and is subject to customary closing conditions, including BioMimetic shareholder approval. We have not yet determined the impact this transaction will have on our goodwill and intangible assets.

7. Accrued Expenses and Other Current Liabilities

Table of Contents

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

Accrued expenses and other current liabilities consist of the following (in thousands):

| | December 31 | |
|---|---|---|
| | 2012 | 2011 |
| Employee bonus | $15,695 | $2,345 |
| Other employee benefits | 8,640 | 7,888 |
| Royalties | 5,313 | 6,887 |
| Taxes other than income | 3,316 | 6,076 |
| Commissions | 3,530 | 5,230 |
| Professional and legal fees | 6,809 | 7,355 |
| Contingent consideration | 444 | 481 |
| Cost improvement restructuring liability (see Note 16) | 110 | 1,948 |
| Product liability | 5,275 | 6,377 |
| Distributor payments | 4,288 | — |
| Other | 11,884 | 11,244 |
| | $65,304 | $55,831 |

Prior to 2012, cash incentive bonuses were paid quarterly. During the year ended December 31, 2012, we elected to pay these bonuses annually.

8. Long-Term Debt and Capital Lease Obligations

Long-term debt and capital lease obligations consist of the following (in thousands):

| | December 31, 2012 | December 31, 2011 |
|---|---|---|
| Capital lease obligations | $ 805 | $ 1,814 |
| Term loan | — | 144,375 |
| 2017 Notes | 254,717 | — |
| 2014 Notes | 3,768 | 29,111 |
| | 259,290 | 175,300 |
| Less: current portion | (786) | (8,508) |
| | $ 258,504 | $ 166,792 |

2017 Cash Convertible Senior Notes

On August 31, 2012, we issued $300 million aggregate principal amount of 2.00% Cash Convertible Senior Notes (2017 Notes) pursuant to an indenture, dated as of August 31, 2012 between us and The Bank of New York Mellon Trust Company, N.A., as Trustee. The 2017 Notes will mature on August 15, 2017 and we will pay interest on the 2017 Notes semiannually on each February 15 and August 15 at an annual rate of 2.00% beginning February 15, 2013. We may not redeem the 2017 Notes prior to the maturity date, and no “sinking fund” is available for the 2017 Notes, which means that we are not required to redeem or retire the 2017 Notes periodically. The 2017 Notes are convertible at the option of the holder, during certain periods and subject to certain conditions as described below, solely into cash at an initial conversion rate of 39.3140 shares per $1,000 principal amount of the 2017 Notes, subject to adjustment upon the occurrence of specified events, which represents an initial conversion price of $25.44 per share. The holder of the 2017 Notes may convert their notes at any time prior to February 15, 2017 only under the following circumstances: (1) during any calendar quarter commencing after the calendar quarter ending December 31, 2012 (and only during such calendar quarter), if the last reported sale price of the common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable

trading day; (2) during the five business day period after any five consecutive trading day period in which the trading price per $1,000 principal amount of notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of our common stock and the conversion rate on each such trading day; or (3) upon the occurrence of specified corporate events. On or after February 15, 2017 until the close of business on the second scheduled trading day immediately preceding the maturity date, holders may convert their notes solely into cash, regardless of the foregoing circumstances. Upon conversion, a holder will receive an amount in cash, per $1,000 principal amount of the 2017 Notes, equal to the settlement amount as calculated under the indenture relating to the 2017 Notes. If we undergo a fundamental change, as defined in the indenture relating to the 2017 Notes, subject to certain conditions, holders of the 2017 Notes will have the option to require us to repurchase for cash all or a portion of their notes at a purchase price equal to

Table of Contents

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

100% of the principal amount of the 2017 Notes to be repurchased, plus any accrued and unpaid interest to, but excluding, the fundamental change repurchase date, as defined in the indenture relating to the 2017 Notes. In addition, following certain corporate transactions, we, under certain circumstances, will pay a cash make-whole premium by increasing the applicable conversion rate for a holder that elects to convert its 2017 Notes in connection with such corporate transaction. The 2017 Notes are senior unsecured obligations that rank: (i) senior in right of payment to any of our indebtedness that is expressly subordinated in right of payment to the 2017 Notes; (ii) equal in right of payment to any of our unsecured indebtedness that is not so subordinated; (iii) effectively junior in right of payment to any secured indebtedness to the extent of the value of the assets securing such indebtedness; and (iv) structurally junior to all indebtedness and other liabilities (including trade payables) of our subsidiaries. As a result of this transaction, we capitalized deferred financing charges of approximately $8.8 million, which are being amortized over the term of the 2017 Notes using the effective interest method.

The cash conversion feature of the 2017 Notes, (2017 Notes Conversion Derivative), requires bifurcation from the 2017 Notes in accordance with ASC Topic 815, Derivatives and Hedging, and is accounted for as a derivative liability. The fair value of the 2017 Notes Conversion Derivative at the time of issuance of the 2017 Notes was $48.1 million and was recorded as original debt discount for purposes of accounting for the debt component of the 2017 Notes. This discount is amortized as interest expense using the effective interest method over the term of the 2017 Notes. For the year ended December 31, 2012 the Company recorded $2.8 million of interest expense related to the amortization of the debt discount based upon an effective rate of 6.47%.

The components of the 2017 Notes were as follows (in thousands):

| | December 31, 2012 | December 31, 2011 |
|---|---|---|
| Principal amount of 2017 Notes | $ 300,000 | $ — |
| Unamortized debt discount | (45,283) | — |
| Net carrying amount of 2017 Notes | $ 254,717 | $ — |

We entered into convertible note hedging transactions (2017 Notes Hedges) in connection with the issuance of the 2017 Notes with three counterparties. The 2017 Notes Hedges, which are cash-settled, are intended to reduce our exposure to potential cash payments that we would be required to make if holders elect to convert the 2017 Notes at a time when our stock price exceeds the conversion price. The aggregate cost to acquire the 2017 Notes Hedges was $56.2 million, and is accounted for as a derivative asset in accordance with ASC Topic 815. See Note 10 for additional information regarding the 2017 Notes Hedges and the 2017 Notes Conversion Derivative.

We also entered into warrant transactions in which we sold warrants for an aggregate of 11.8 million shares of our common stock to the counterparties, subject to adjustment. The strike price of the warrants will initially be $29.925 per share, which was 50% above the last reported sale price of our common stock on August 22, 2012. The warrants are net-share settled and are exercisable over the 100 trading day period beginning on November 15, 2017. We determined that the warrants met the requirements for equity classification pursuant to ASC Topic 815 and are not required to be accounted for as derivatives. The warrant transactions will have a dilutive effect to the extent that the market value per share of our common stock during such period exceeds the applicable strike price of the warrants. We received approximately $34.6 million from the counterparties for the warrants, which was recorded as an increase in stockholders equity, and incurred equity issuance costs of $0.8 million.

Aside from the initial payment of the $56.2 million premium to the counterparties, we will not be required to make any cash payments to the counterparties under the 2017 Notes Hedges and will be entitled to receive from the counterparties cash, generally equal to the amount by which the market price per share of common stock exceeds the strike price of the convertible note hedging transactions during the relevant valuation period. The strike price under the 2017 Notes Hedges is equal to the conversion price of the 2017 Notes. Additionally, if the market value per share

of our common stock exceeds the strike price on any day during the 100 trading day measurement period under the warrant transaction, we will be obligated to issue to the counterparties a number of shares equal in value to one percent of the amount by which the then-current market value of one share of our common stock exceeds the then-effective strike price of each warrant, multiplied by the number of shares of common stock into which the 2017 Notes are then convertible at or following maturity. We will not receive any additional proceeds if warrants are exercised.

2014 Convertible Senior Notes

In November 2007, we issued $200 million of 2.625% Convertible Senior Notes due 2014 (2014 Notes). The 2014 Notes will mature on December 1, 2014. The 2014 Notes pay interest semiannually at an annual rate of 2.625% and are convertible into shares of our common stock at an initial conversion rate of 30.6279 shares per $1,000 principal amount of the 2014 Notes subject to adjustment upon the occurrence of specified events, which represents an initial conversion price of $32.65 per share. The holder of the 2014 Notes may convert at any time on or prior to the close of business on the business day immediately preceding the

Table of Contents

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

maturity date of 2014 Notes. Beginning on December 6, 2011, we may redeem the 2014 Notes, in whole or in part, at a redemption price equal to 100% of the principal amount of the 2014 Notes, plus accrued and unpaid interest, if the closing price of our common stock has exceeded 140% of the conversion price for at least 20 days during any consecutive 30-day trading period. Additionally, if we experience a fundamental change event, as defined in the indenture governing the 2014 Notes (Indenture), the holders may require us to purchase for cash all or a portion of the 2014 Notes, for 100% of the principal amount of the notes, plus accrued and unpaid interest. If upon a fundamental change event, a holder elects to convert its 2014 Notes, we may, under certain circumstances, increase the conversion rate for the 2014 Notes surrendered. The 2014 Notes are unsecured obligations and are effectively subordinated to (i) all of our existing and future secured debt, including our obligations under our credit agreement, to the extent of the value of the assets securing such debt, and (ii) because the 2014 Notes are not guaranteed by any of our subsidiaries, to all liabilities of our subsidiaries.

On February 10, 2011, we announced the commencement of a tender offer to purchase for cash any and all of our outstanding 2014 Notes. Upon expiration on March 11, 2011, we purchased $170.9 million aggregate principal amount of the 2014 Notes.

On August 22, 2012, we purchased $25.3 million aggregate principal amount of the 2014 Notes. As a result of this transaction, we recognized approximately $0.2 million for the write off of related pro-rata unamortized deferred financing fees. As of December 31, 2012, $3.8 million aggregate principal amount of the 2014 Notes remain outstanding.

Senior Credit Facility

On February 10, 2011, we entered into an amended and restated revolving credit agreement (Senior Credit Facility). The Senior Credit Facility has revolver availability of $200 million and availability in a delayed draw term loan of up to $150 million.

In March 2011, to fund the purchase of the 2014 Notes, we borrowed $150 million under the delayed draw term loan (Term Loan) facility available under our Senior Credit Facility.

On August 22, 2012, we used approximately $130 million of proceeds from the issuance of the 2017 Notes to repay the Term Loan, and we terminated our Senior Credit Facility. As a result of this transaction, we recognized approximately $2.5 million for the write off of previously capitalized deferred financing fees.

Interest Rate Swap

In March 2011, we entered into an interest rate swap agreement with a notional amount of $50 million, which we designated as a cash flow hedge of the underlying variable rate obligation on our Term Loan. Due to the repayment of the Term Loan, we terminated the swap on August 22, 2012 and recognized a loss of $1.8 million within "Other expense, net".

Maturities

Aggregate annual maturities of our long-term obligations at December 31, 2012, excluding capital lease obligations, are as follows (in thousands):

| | |
|---|---|
| 2013 | $— |
| 2014 | 3,768 |
| 2015 | — |
| 2016 | — |
| 2017 | 300,000 |
| | $303,768 |

Table of Contents

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

As discussed in Note 5, we have acquired certain property and equipment pursuant to capital leases. At December 31, 2012, future minimum lease payments under capital lease obligations, together with the present value of the net minimum lease payments, are as follows (in thousands):

| | |
|---|---|
| 2013 | $811 |
| 2014 | 17 |
| 2015 | 2 |
| 2016 | — |
| 2017 | — |
| Total minimum payments | 830 |
| Less amount representing interest | (25) |
| Present value of minimum lease payments | 805 |
| Current portion | (786) |
| Long-term portion | $19 |

9. Other Long-Term Liabilities

Other long-term liabilities consist of the following (in thousands):

| | December 31 | |
|---|---|---|
| | 2012 | 2011 |
| Unrecognized tax benefits (See Note 11) | $5,074 | $3,688 |
| Product liability (See Note 17) | 18,639 | 17,273 |
| 2017 Notes Conversion Derivative (See Note 10) | 55,000 | — |
| Other | 8,211 | 10,784 |
| | $86,924 | $31,745 |

10. Derivative Instruments and Hedging Activities

We account for derivatives in accordance with FASB ASC 815, which establishes accounting and reporting standards requiring that derivative instruments be recorded on the balance sheet as either an asset or liability measured at fair value. Additionally, changes in the derivative's fair value shall be recognized currently in earnings unless specific hedge accounting criteria are met. If hedge accounting criteria are met for cash flow hedges, the changes in a derivative's fair value are recorded in stockholders' equity as a component of other comprehensive income, net of tax. These deferred gains and losses are recognized in income in the period in which the hedge item and hedging instrument affect earnings.

Conversion Derivative and Notes Hedging

On August 31, 2012, we issued the 2017 Notes. The cash conversion feature of the 2017 Notes (2017 Notes Conversion Derivative) requires bifurcation from the 2017 Notes in accordance with ASC Topic 815, and is accounted for as a derivative liability. The fair value of the 2017 Notes Conversion Derivative at the time of issuance of the 2017 Notes was $48.1 million. See Note 8 for additional information regarding the 2017 Notes.

We also entered into convertible note hedging transactions (2017 Notes Hedges) in connection with the issuance of the 2017 Notes with three counterparties. The 2017 Notes Hedges, which are cash-settled, are intended to reduce our exposure to potential cash payments that we are required to make upon conversion of the 2017 Notes in excess of the principal amount of converted notes if our common stock price exceeds the conversion price. The aggregate cost of the 2017 Notes Hedges was $56.2 million and is accounted for as a derivative asset in accordance with ASC Topic 815.

The following table summarizes the fair value and the presentation in the consolidated balance sheet (in thousands):

| | Location on consolidated | December 31, 2012 |
|---|---|---|

| | | |
|---|---|---|
| | balance sheet | |
| 2017 Notes Hedges | Other assets | $ 62,000 |
| 2017 Notes Conversion Derivative | Other liabilities | $ 55,000 |

Table of Contents

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

Neither the 2017 Notes Conversion Derivative nor the 2017 Notes Hedges qualify for hedge accounting, thus any change in the fair value of the derivatives is recognized immediately in the consolidated statements of operations. The following table summarizes the gain (loss) on changes in fair value (in thousands):

| | Twelve Months Ended December 31, 2012 |
|---|---|
| 2017 Notes Hedges | $5,805 |
| 2017 Notes Conversion Derivative | (6,947) |
| Net loss on changes in fair value | $(1,142) |

Interest Rate Hedging

On March 14, 2011, we entered into an interest rate swap intended to hedge our variable interest rate obligations with respect to a portion of the our Senior Credit Facility discussed in Note 8. This interest rate swap is a contract to exchange fixed rate payments for floating rate payments over the life of the agreement without the exchange of the underlying notional amount. The notional amount of the interest rate swap is used to measure interest to be paid or received and does not represent the amount of exposure to credit loss. Under the terms of the interest rate swap agreement, we received interest on the $50 million notional amount based on one-month LIBOR and we paid a fixed rate of 1.74%. This swap effectively converted $50 million of our variable-rate borrowings to fixed-rate borrowings beginning on March 31, 2011 and through February 27, 2015, with the exception of the variability of the rate based on our consolidated leverage ratio.

In accordance with FASB ASC Topic 815, we designated the above interest rate swap as a cash flow hedge and formally documented the relationship between the interest rate swap and the term loan borrowing, as well as our risk management objective and strategy for undertaking the hedge transaction. This process included linking the derivative to the specific liability on the balance sheet. We assessed whether the derivative used in the hedging transaction was highly effective in offsetting changes in the cash flows of the hedged item at inception and will test both retrospectively and prospectively on an ongoing basis. The effective portion of unrealized gains (losses) on the derivative instrument used in the hedging transaction was deferred as a component of accumulated other comprehensive income (AOCI) and was recognized in earnings at the time the hedged item affected earnings. Any ineffective portion of the change in fair value would have been immediately recognized in earnings.

On August 22, 2012, we terminated our Senior Credit Facility and the interest rate swap. Upon termination, we recognized a charge of $1.8 million, which represented the unrealized loss on the derivative instrument that had been previously deferred as a component of AOCI.

This derivative instrument, designated as a cash flow hedge, had the following effect on AOCI in our consolidated balance sheet for the twelve months ended December 31, 2012 (in thousands):

| | 2012 |
|---|---|
| Balance at January 1 | $(1,662) |
| Current period amount of loss recognized in AOCI | (107) |
| Net amount reclassified into earnings | 1,769 |
| Balance at December 31 | $— |

Derivatives not Designated as Hedging Instruments

We employ a derivative program using 30-day foreign currency forward contracts to mitigate the risk of currency fluctuations on our intercompany receivable and payable balances that are denominated in foreign currencies. These forward contracts are expected to offset the transactional gains and losses on the related intercompany balances. These forward contracts are not designated as hedging instruments under FASB ASC Topic 815. Accordingly, the changes

in the fair value and the settlement of the contracts are recognized in the period incurred in the accompanying condensed consolidated statements of operations. At December 31, 2012, we had no foreign currency contracts outstanding.

Table of Contents

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

11. Income Taxes

The components of our income (loss) before income taxes are as follows (in thousands):

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| U.S. | $1,367 | $(15,738) | $24,507 |
| Foreign | 7,194 | 9,083 | 6,414 |
| Income (loss) before income taxes | $8,561 | $(6,655) | $30,921 |

The components of our provision (benefit) for income taxes are as follows (in thousands):

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Current (benefit) provision: | | | |
| U.S.: | | | |
| Federal | $(2,700) | $2,956 | $(11) |
| State | 239 | 416 | 1,160 |
| Foreign | 1,952 | 2,085 | 2,687 |
| Total current (benefit) provision | (509) | 5,457 | 3,836 |
| Deferred provision (benefit): | | | |
| U.S.: | | | |
| Federal | 3,404 | (6,376) | 9,166 |
| State | (139) | (1,141) | 375 |
| Foreign | 521 | 548 | (297) |
| Total deferred provision (benefit) | 3,786 | (6,969) | 9,244 |
| Total provision (benefit) for income taxes | $3,277 | $(1,512) | $13,080 |

A reconciliation of the statutory U.S. federal income tax rate to our effective income tax rate is as follows:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Income tax provision at statutory rate | 35.0 % | 35.0 % | 35.0 % |
| State income taxes | 0.6 % | 10.3 % | 4.0 % |
| Change in valuation allowance | (1.9)% | (1.3)% | 1.8 % |
| Research and development credit | — % | 8.3 % | (2.7)% |
| Foreign income tax rate differences | (12.1)% | 4.5 % | (3.5)% |
| Non-deductible stock-based compensation expense | 3.0 % | (5.9)% | 2.0 % |
| Other non-deductible expenses | 2.9 % | (4.4)% | 5.3 % |
| Tax settlement | — % | (15.6)% | — % |
| Transaction costs | 8.4 % | — % | — % |
| Deferred tax write off | 6.9 % | (4.6)% | — % |
| Other, net | (4.5)% | (3.6)% | 0.4 % |
| Total | 38.3 % | 22.7 % | 42.3 % |

The American Taxpayer Relief Act of 2012 (Act) was enacted on January 2, 2013. The Act retroactively reinstates the federal research and development credit from January 1, 2012, through December 31, 2013. The effect of the change in the tax law related to 2012 is estimated to be approximately $0.5 million, which will be recognized as a benefit to income tax expense in the first quarter of 2013, the quarter in which the law was enacted.

78

Table of Contents

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

The significant components of our deferred income taxes as of December 31, 2012 and 2011 are as follows (in thousands):

| | December 31, 2012 | 2011 |
|---|---|---|
| Deferred tax assets: | | |
| Net operating loss carryforwards | $17,009 | $21,759 |
| General business credit carryforward | 734 | 1,892 |
| Reserves and allowances | 38,263 | 40,623 |
| Stock-based compensation expense | 7,256 | 6,456 |
| Convertible debt notes and conversion option | 22,173 | — |
| Other | 7,244 | 7,840 |
| Valuation allowance | (14,248) | (14,271) |
| Total deferred tax assets | 78,431 | 64,299 |
| Deferred tax liabilities: | | |
| Depreciation | 20,016 | 23,734 |
| Intangible assets | 2,828 | 2,675 |
| Convertible note bond hedge | 21,916 | — |
| Other | 8,270 | 5,029 |
| Total deferred tax liabilities | 53,030 | 31,438 |
| Net deferred tax assets | $25,401 | $32,861 |

Outside basis differences that have not been tax-effected in accordance with FASB ASC 740 are primarily related to undistributed earnings of certain of our foreign subsidiaries. Deferred tax liabilities for U.S. federal income taxes are not provided on the undistributed earnings of our foreign subsidiaries that are considered permanently reinvested. The determination of the amount of unrecognized deferred tax liabilities is not practicable.

At December 31, 2012, we had net operating loss carryforwards for U.S. federal income tax purposes of approximately $6.2 million, which begin to expire in 2018 and extend through 2029. Additionally, we had general business credit carryforwards of approximately $1.5 million, which begin to expire in 2018 and extend through 2031. At December 31, 2012, we had foreign net operating loss carryforwards of approximately $44.0 million, the majority of which do not expire.

Certain of our U.S. and foreign net operating losses and general business credit carryforwards are subject to various limitations. We maintain valuation allowances for those net operating losses and tax credit carryforwards that we do not expect to utilize due to these limitations and it is more likely than not that such tax benefits will not be realized.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

| | |
|---|---|
| Balance at January 1, 2012 | $3,688 |
| Additions for tax positions related to current year | 933 |
| Additions for tax positions of prior years | 504 |
| Reductions for tax positions of prior years | (86) |
| Settlements | — |
| Foreign currency translation | 35 |
| Balance at December 31, 2012 | $5,074 |

As of December 31, 2012, our liability for unrecognized tax benefits totaled $5.1 million and is recorded in our consolidated balance sheet within “Other liabilities,” and all components, if recognized, would impact our effective tax rate. Our U.S. federal income taxes represent the substantial majority of our income taxes, and our 2009 and 2010 U.S. federal income tax return are currently under examination by the Internal Revenue Service. It is therefore possible that our unrecognized tax benefits could change in the next twelve months.

We accrue interest required to be paid by the tax law for the underpayment of taxes on the difference between the amount claimed or expected to be claimed on the tax return and the tax benefit recognized in the financial statements. Management has made the

Table of Contents

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

policy election to record this interest as interest expense. As of December 31, 2012, accrued interest related to our unrecognized tax benefits totaled approximately $0.4 million which is recorded in our consolidated balance sheet within “Other liabilities.”

We file numerous consolidated and separate company income tax returns in the U.S. and in many foreign jurisdictions. We are no longer subject to foreign income tax examinations by tax authorities in significant jurisdictions for years before 2007. With few exceptions, we are subject to U.S. federal, state and local income tax examinations for years 2009 through 2011. However, tax authorities have the ability to review years prior to these to the extent that we utilize tax attributes carried forward from those prior years.

12. Earnings Per Share

FASB ASC Section 260, Earnings Per Share, requires the presentation of basic and diluted earnings per share. Basic earnings per share is calculated based on the weighted-average number of shares of common stock outstanding during the period. Diluted earnings per share is calculated to include any dilutive effect of our common stock equivalents. Our common stock equivalents consist of stock options, non-vested shares of common stock, stock-settled phantom stock units, restricted stock units, 2014 convertible debt, and warrants. The dilutive effect of the stock options, non-vested shares of common stock, stock-settled phantom stock units, and restricted stock units is calculated using the treasury-stock method. The dilutive effect of 2014 convertible debt is calculated by applying the “if-converted” method. This assumes an add-back of interest, net of income taxes, to net income as if the securities were converted at the beginning of the period. We determined that for the years ended December 31, 2012, 2011, and 2010, the convertible debt had an anti-dilutive effect on earnings per share and we therefore excluded it from the dilutive shares calculation. For the year ended December 31, 2012, the warrants were excluded from diluted shares outstanding because the exercise price exceeded the average market price of our common stock. In addition, 136,000 common stock equivalents have been excluded from the computation of diluted net loss per share for the year ended December 31, 2011, because the effect is anti-dilutive as a result of our net loss.

The weighted-average number of common shares outstanding for basic and diluted earnings per share purposes is as follows (in thousands):

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Weighted-average number of common shares outstanding — basic | 38,769 | 38,279 | 37,802 |
| Common stock equivalents | 317 | — | 159 |
| Weighted-average number of common shares outstanding — diluted | 39,086 | 38,279 | 37,961 |

The following potential common shares were excluded from the computation of diluted earnings per share as their effect would have been anti-dilutive (in thousands):

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Stock options | 2,854 | 3,400 | 3,766 |
| Non-vested shares, restricted stock units, and stock-settled phantom stock units | 290 | 430 | 621 |
| Convertible debt | 633 | 1,909 | 6,126 |
| Warrants | 11,794 | — | — |

13. Capital Stock

We are authorized to issue up to 100,000,000 shares of voting common stock. We have 60,296,642 shares of voting common stock available for future issuance at December 31, 2012, of which approximately 6.7 million shares will be issued upon the successful closing of the BioMimetic acquisition.

80

Table of Contents

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

14. Stock-Based Compensation Plans

We have three stock-based compensation plans which are described below. Amounts recognized in the consolidated financial statements with respect to these plans are as follows:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Total cost of share-based payment plans | $10,932 | $9,076 | $13,217 |
| Amounts capitalized as inventory and intangible assets | (1,371) | (1,392) | (1,353) |
| Amortization of capitalized amounts | 1,413 | 1,424 | 1,313 |
| Charged against income before income taxes | 10,974 | 9,108 | 13,177 |
| Amount of related income tax benefit recognized in income | (3,767) | (2,946) | (4,410) |
| Impact to net income | $7,207 | $6,162 | $8,767 |
| Impact to basic earnings per share | $0.19 | $0.16 | $0.23 |
| Impact to diluted earnings per share | $0.18 | $0.16 | $0.23 |

As of December 31, 2012, we had $18.1 million of total unrecognized compensation cost related to unvested stock-based compensation arrangements granted to employees. That cost is expected to be recognized over a weighted-average period of 2.7 years.

Equity Incentive Plans.

On December 7, 1999, we adopted the 1999 Equity Incentive Plan, which was subsequently amended and restated on July 6, 2001, May 13, 2003, May 13, 2004, May 12, 2005 and May 14, 2008 and amended on October 23, 2008. The 1999 Equity Incentive Plan expired December 7, 2009. The 2009 Equity Incentive Plan (the Plan) was adopted on May 13, 2009, which was subsequently amended and restated on May 13, 2010. The Plan authorizes us to grant stock options and other stock-based awards, such as non-vested shares of common stock, with respect to up to 11,917,051 shares of common stock, of which full value awards (such as non-vested shares) are limited to 2,729,555 shares. Under the Plan, stock based compensation awards generally are exercisable in increments of 25% annually on each of the first through fourth anniversaries of the date of grant. All of the options issued under the plan expire after 10 years. These awards are recognized on a straight-line basis over the requisite service period, which is generally 4 years. As of December 31, 2012, there were 1,588,329 shares available for future issuance under the Plan, of which full value awards are limited to 321,412 shares.

Stock options

We estimate the fair value of stock options using the Black-Scholes valuation model. The Black-Scholes option-pricing model requires the input of estimates, including the expected life of stock options, expected stock price volatility, the risk-free interest rate and the expected dividend yield. The expected life of options is estimated based on historical option exercise and employee termination data. The expected stock price volatility assumption was estimated based upon historical volatility of our common stock. The risk-free interest rate was determined using U.S. Treasury rates where the term is consistent with the expected life of the stock options. Expected dividend yield is not considered as we have never paid dividends and have no plans of doing so in the future. We are required to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. We use historical data to estimate pre-vesting forfeitures and record stock-based compensation expense only for those awards that are expected to vest. The fair value of stock options is amortized on a straight-line basis over the respective requisite service period, which is generally the vesting period.

The weighted-average grant date fair value of stock options granted to employees in 2012, 2011, and 2010 was $7.92 per share, $5.97 per share, and $7.11 per share, respectively. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option valuation model using the following assumptions:

| | Year Ended December 31, |
|---|---|

| | 2012 | 2011 | 2010 |
|---|---|---|---|
| Risk-free interest rate | 0.5% - 1.0% | 1.0% - 2.0% | 2.1% - 2.2% |
| Expected option life | 6 years | 6 years | 6 years |
| Expected price volatility | 40% | 39% | 40% |

Table of Contents

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

A summary of our stock option activity during 2012 is as follows:

| | Shares (000's) | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Life | Aggregate Intrinsic Value* ($000's) |
|---|---|---|---|---|
| Outstanding at December 31, 2011 | 2,760 | $ 23.23 | | |
| Granted | 803 | 21.19 | | |
| Exercised | (88) | 17.57 | | |
| Forfeited or expired | (293) | 22.70 | | |
| Outstanding at December 31, 2012 | 3,182 | $ 22.92 | 5.3 | $3,246 |
| Exercisable at December 31, 2012 | 2,056 | $ 24.72 | 3.2 | $1,413 |

* The aggregate intrinsic value is calculated as the difference between the market value of our common stock as of December 31, 2012, and the exercise price of the shares. The market value as of December 31, 2012 is $20.99 per share, which is the closing sale price of our common stock reported for transactions effected on the Nasdaq Global Select Market on December 31, 2012.

The total intrinsic value of options exercised during 2012, 2011, and 2010 was $0.3 million, $0.1 million, and $0.6 million, respectively.

A summary of our stock options outstanding and exercisable at December 31, 2012, is as follows (shares in thousands):

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| Range of Exercise Prices | Number Outstanding | Weighted-Average Remaining Contractual Life | Weighted-Average Exercise Price | Number Exercisable | Weighted-Average Exercise Price |
| $4.00 — $16.00 | 423 | 7.6 | $ 15.46 | 159 | $ 15.45 |
| $16.01 — $24.00 | 1,591 | 6.5 | 21.12 | 729 | 21.40 |
| $24.01 — $35.87 | 1,168 | 2.4 | 28.06 | 1,168 | 28.06 |
| | 3,182 | 5.2 | $ 22.92 | 2,056 | $ 24.72 |

Inducement Stock Options.

During 2011, we granted 610,000 stock options under an inducement stock option agreement with an exercise price of $16.03 to induce Robert J. Palmisano to commence employment with us as our Chief Executive Officer. These options vest over a three-year service period. We also granted 30,000 stock options with an exercise price of $18.33 to Julie Tracy, Senior Vice President, Chief Communications Officer, and 65,000 stock options with an exercise price of $16.23 to James Lightman, Senior Vice President, General Counsel, and Secretary, under inducement stock option agreements. During 2012, we granted 50,000 stock options with an exercise price of $17.35 to induce Daniel Garen to commence employment with us as our Senior Vice President and Chief Compliance Officer and 184,500 stock options with an exercise price of $21.24 to Pascal E. R. Girin, Executive Vice President and Chief Operating Officer. These options have substantially the same terms as grants made under the Plan.

Table of Contents

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

A summary of our inducement grant stock option activity during 2012 is as follows:

| | Shares (000's) | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Life | Aggregate Intrinsic Value* ($000's) |
|---|---|---|---|---|
| Outstanding at December 31, 2011 | 705 | $ 16.15 | | |
| Granted | 235 | 20.41 | | |
| Exercised | — | — | | |
| Forfeited or expired | — | — | | |
| Outstanding at December 31, 2012 | 940 | $ 17.21 | 8.8 | $3,597 |
| Exercisable at December 31, 2012 | 227 | $ 16.12 | 8.6 | $1,106 |

* The aggregate intrinsic value is calculated as the difference between the market value of our common stock as of December 31, 2012, and the exercise price of the shares. The market value as of December 31, 2012 is $20.99 per share, which is the closing sale price of our common stock reported for transactions effected on the Nasdaq Global Select Market on December 31, 2012.

A summary of our stock options outstanding and exercisable at December 31, 2012, is as follows (shares in thousands):

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| Range of Exercise Prices | Number Outstanding | Weighted-Average Remaining Contractual Life | Weighted-Average Exercise Price | Number Exercisable | Weighted-Average Exercise Price |
| $4.00 — $16.00 | 422 | 7.6 | $ 15.46 | 159 | $ 15.45 |
| $16.01 — $24.00 | 2,531 | 7.4 | 19.67 | 957 | 20.15 |
| $24.01 — $35.87 | 1,168 | 2.4 | 28.06 | 1,168 | 28.06 |
| | 4,121 | 6.0 | $ 21.62 | 2,284 | $ 23.87 |

Non-vested shares and stock settled phantom stock units and restricted stock units

We calculate the grant date fair value of non-vested shares of common stock, stock settled phantom stock units and restricted stock units using the closing sale prices on the trading day immediately prior to the grant date. We are required to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. We use historical data to estimate pre-vesting forfeitures and record stock-based compensation expense only for those awards that are expected to vest.

Under the Plan, we granted 298,000, 483,000, and 588,000 non-vested shares of common stock, stock settled phantom stock units and restricted stock units to employees with weighted-average grant-date fair values of $21.26 per share, $15.52 per share, and $18.34 per share during 2012, 2011, and 2010, respectively. The fair value of these shares will be recognized on a straight-line basis over the respective requisite service period, which is generally the vesting period.

During 2012, we granted a negligible amount of non-vested shares to non-employees. During 2011 and 2010, we granted certain independent distributors and other non-employees non-vested shares of common stock of 28,000 and 5,000 shares at a weighted-average grant date fair values of $15.27 per share and $18.20 per share, respectively.

A summary of our non-vested shares of common stock activity during 2012 is as follows:

| | Shares (000's) | Weighted-Average Grant-Date Fair Value | Aggregate Intrinsic Value* |
|---|---|---|---|

| | | | ($000's) |
|---|---|---|---|
| Non-vested at December 31, 2011 | 1,027 | $ 17.08 | |
| Granted | 298 | 21.26 | |
| Vested | (426) | 18.02 | |
| Forfeited | (85) | 17.21 | |
| Non-vested at December 31, 2012 | 814 | $ 18.10 | $17,082 |

_____

Table of Contents

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

* The aggregate intrinsic value is calculated as the market value of our common stock as of December 31, 2012. The market value as of December 31, 2012 is $20.99 per share, which is the closing sale price of our common stock reported for transactions effected on the Nasdaq Global Select Market on December 31, 2012.

The total fair value of shares vested during 2012, 2011 and 2010 was $8.9 million, $6.9 million and $6.3 million, respectively.

Employee Stock Purchase Plan.

On May 30, 2002, our shareholders approved and adopted the 2002 Employee Stock Purchase Plan (the ESPP). The ESPP authorizes us to issue up to 200,000 shares of common stock to our employees who work at least 20 hours per week. Under the ESPP, there are two six-month plan periods during each calendar year, one beginning January 1 and ending on June 30, and the other beginning July 1 and ending on December 31. Under the terms of the ESPP, employees can choose each plan period to have up to 5% of their annual base earnings, limited to $5,000, withheld to purchase our common stock. The purchase price of the stock is 85% of the lower of its beginning-of-period or end-of-period market price. Under the ESPP, we sold to employees approximately 25,000, 26,000, and 28,000 shares in 2012, 2011, and 2010, respectively, with weighted-average fair values of $5.93, $4.92, and $5.41 per share, respectively. As of December 31, 2012, there were 17,725 shares available for future issuance under the ESPP. During 2012, 2011, and 2010, we recorded nominal amounts of non-cash, stock-based compensation expense related to the ESPP.

In applying the Black-Scholes methodology to the purchase rights granted under the ESPP, we used the following assumptions:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Risk-free interest rate | 0.1% - 0.2% | 0.3% - 0.4% | 0.6% - 0.9% |
| Expected option life | 6 months | 6 months | 6 months |
| Expected price volatility | 40% | 39% | 40% |

15. Employee Benefit Plans

We sponsor a defined contribution plan under Section 401(k) of the Internal Revenue Code, which covers U.S. employees who are 21 years of age and over. Under this plan, we match voluntary employee contributions at a rate of 100% for the first 2% of an employee’s annual compensation and at a rate of 50% for the next 2% of an employee’s annual compensation. Employees vest in our contributions after three years of service. Our expense related to the plan was $1.8 million in 2012, 2011 and 2010.

16. Restructuring

On September 15, 2011, we announced plans to implement a cost restructuring plan to foster growth, enhance profitability and cash flow, and build stockholder value. We have implemented numerous initiatives to reduce spending, including streamlining select aspects of our international selling and distribution operations, reducing the size of our product portfolio, adjusting plant operations to align with our volume and mix expectations and rationalizing our research and development projects. In total, we reduced our workforce by approximately 80 employees, or 6%.

We have concluded our cost improvement restructuring efforts, incurring a total of $18.5 million of charges; however, certain liabilities remain to be paid.

Charges associated with the restructuring are presented in the following table. All of the following amounts were recognized within “Restructuring charges” in our consolidated statement of operations, with the exception of the excess and obsolete inventory charges, which were recognized within "Cost of sales - restructuring."

| (in thousands) | Year Ended | Cumulative Charges as of |
|---|---|---|

| | December 31, 2012 | December 31, 2012 |
|---|---|---|
| Severance and other termination benefits | $38 | $5,454 |
| Contract terminations | 125 | 6,102 |
| Non-cash asset impairment charges | 223 | 2,676 |
| Excess and obsolete charges | 435 | 2,906 |
| Legal and professional fees | 205 | 508 |
| Other | 562 | 818 |
| Total restructuring charges | $1,588 | $18,464 |

Table of Contents

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

Activity in this Cost Improvement restructuring liability for the year ended December 31, 2012, is presented in the following table (in thousands):

| | |
|---|---|
| Beginning balance | $1,948 |
| Charges: | |
| Severance and other termination benefits | 38 |
| Contract terminations | 125 |
| Legal and professional fees | 205 |
| Other | 562 |
| Total Charges | 930 |
| | |
| Payments: | |
| Severance and other termination benefits | (1,443) |
| Contract terminations | (357) |
| Legal and professional fees | (259) |
| Other | (759) |
| Total Payments | (2,818) |
| | |
| Changes in foreign currency translation | 9 |
| Cost Improvement restructuring liability at December 31, 2012 | $69 |

17. Commitments and Contingencies

Operating Leases. We lease certain equipment and office space under non-cancelable operating leases. Rental expense under operating leases approximated $11.6 million, $12.3 million, and $11.3 million for the years ended December 31, 2012, 2011, and 2010, respectively. In addition, in 2011, as a result of our restructuring efforts, we recorded approximately $0.4 million for terminations of operating leases. Future minimum payments, by year and in the aggregate, under non-cancelable operating leases with initial or remaining lease terms of one year or more, are as follows at December 31, 2012 (in thousands):

| | |
|---|---|
| 2013 | $9,360 |
| 2014 | 5,861 |
| 2015 | 2,240 |
| 2016 | 602 |
| 2017 | 567 |
| Thereafter | 325 |
| | $18,955 |

Purchase Obligations. We have entered into certain supply agreements for our products, which include minimum purchase obligations. During the year ended December 31, 2012, we paid immaterial amounts under those supply agreements. During the years ended December 31, 2011, and 2010, we paid approximately $7.7 million and $6.1 million, respectively, under those supply agreements. At December 31, 2012, we have immaterial obligations for minimum purchases under those supply agreements.

Portions of our payments for operating leases are denominated in foreign currencies and were translated in the tables above based on their respective U.S. dollar exchange rates at December 31, 2012. These future payments are subject to foreign currency exchange rate risk.

Governmental Inquiries. In December 2007, we received a subpoena from the United States Department of Justice (DOJ) through the United States Attorney's Office for the District of New Jersey (USAO) requesting documents for the period January 1998 through the present related to any consulting and professional service agreements with

orthopaedic surgeons in connection with hip or knee joint replacement procedures or products. This subpoena was served shortly after several of our knee and hip competitors agreed with the DOJ to resolutions of similar investigations.

On September 29, 2010, WMT entered into a 12-month Deferred Prosecution Agreement (DPA) with the USAO and a Civil Settlement Agreement (CSA) with the United States. Under the DPA, the USAO filed a criminal complaint in the United States District Court for the District of New Jersey Court charging WMT with conspiracy to commit violations of the Anti-Kickback Statute (42 U.S.C. § 1320a-7b) during the years 2002 through 2007. The court deferred prosecution of the criminal complaint

Table of Contents

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

during the term of the DPA and the USAO agreed that if WMT complied with the DPA's provisions, the USAO would seek dismissal of the criminal complaint.

Pursuant to the CSA, WMT settled civil and administrative claims relating to the matter for a payment of $7.9 million without any admission by WMT. In conjunction with the CSA, WMT also entered into a five year Corporate Integrity Agreement (CIA) with the Office of the Inspector General of the United States Department of Health and Human Services (OIG-HHS). Pursuant to the DPA, an independent monitor reviewed and evaluated WMT’s compliance with its obligations under the DPA. The DPA and the CIA were filed as Exhibits 10.3 and 10.2, respectively, to our current report on Form 8-K filed on September 30, 2010. The DPA was also posted to our website. Each of the DPA and the CIA could be modified by mutual consent of the parties thereto.

On September 15, 2011, WMT reached an agreement with the USAO and the OIG-HHS under which WMT voluntarily agreed to extend the term of its DPA for 12 months, to September 29, 2012. On September 15, 2011, WMT also agreed with the OIG-HHS to an amendment to the CIA under which certain of WMT's substantive obligations under the CIA would begin on September 29, 2012, when the amended DPA monitoring period expired. The term of the CIA has not changed, and will expire as previously provided on September 29, 2015.

On October 4, 2012, the USAO issued a press release announcing that the amended DPA had expired on September 29, 2012, that it had moved to dismiss the criminal complaint against WMT because WMT had fully complied with the terms of the DPA, and that the Court had ordered dismissal of the complaint on October 4, 2012.

The DPA imposed, and the CIA continues to impose, certain obligations on WMT to maintain compliance with U.S. healthcare laws, regulations and other requirements. Our failure to do so could expose us to significant liability including, but not limited to, exclusion from federal healthcare program participation, including Medicaid and Medicare, which would have a material adverse effect on our financial condition, results of operations and cash flows, potential prosecution, civil and criminal fines or penalties, and additional litigation cost and expense.

In addition to the USAO and OIG-HHS, other governmental agencies, including state authorities, could conduct investigations or institute proceedings that are not precluded by the terms of the settlements reflected in the DPA and the CIA. In addition, the settlement with the USAO and OIG-HHS could increase our exposure to lawsuits by potential whistleblowers, including under the federal false claims acts, based on new theories or allegations arising from the allegations made by the USAO. The costs of defending or resolving any such investigations or proceedings could have a material adverse effect on our financial condition, results of operations and cash flows.

On August 3, 2012, we received a subpoena from the U.S. Attorney's Office for the Western District of Tennessee requesting records and documentation relating to our PROFEMUR® series of hip replacement devices. The subpoena covers the period from January 1, 2000 to August 2, 2012. We are in the process of collecting the responsive documents and responding to the subpoena. We are unable to estimate the impact of the ultimate outcome of these matters on our consolidated financial position or results of operations.

Patent Litigation. In 2011, Howmedica Osteonics Corp. (Howmedica) and Stryker Ireland, Ltd. (Stryker), each a subsidiary of Stryker Corporation, filed a lawsuit against WMT in the United States District Court for the District of New Jersey (District Court) alleging that we infringed Howmedica and Stryker’s U.S. Patent No. 6,475,243 related to our LINEAGE® Acetabular Cup System and DYNASTY® Acetabular Cup System. The lawsuit seeks an order of infringement, injunctive relief, unspecified damages, and various other costs and relief and could impact a substantial portion of our knee product line. We believe, however, that we have strong defenses against these claims and plan to vigorously defend this lawsuit. Management does not believe that the outcome of this lawsuit will have a material adverse effect on our consolidated financial position or results of operations.

During 2012, Bonutti Skeletal Innovations, LLC filed a patent infringement lawsuit against us in the District of Delaware. Bonutti originally alleged that Wright's Link Sled Prosthesis infringes U.S. Patent 6,702,821. Wrights distributes the Link Sled Prosthesis under a June 1, 2008 distribution agreement with LinkBio Corp. In January 2013, Bonutti amended its complaint, alleging that Wright's ADVANCE® knee system, including ODYSSEY®

instrumentation, infringes U.S. Patent 8,133,229, and that Wright's ADVANCE® knee system, including ODYSSEY® instrumentation and PROPHECY® guides, infringes U.S. Patent 7,806,896, which issued October 5, 2010. All of the claims of the asserted patents are directed to surgical methods for minimally invasive surgery. We do not believe the initial complaint will have a material adverse impact to our consolidated financial position or results of operations. We are currently evaluating the additional allegations filed in January and plan to vigorously defend these allegations.

Product Liability. We have received claims for personal injury against us associated with fractures of our PROFEMUR® long titanium modular neck product (PROFEMUR® Claims). The overall fracture rate for the product is low and the fractures appear, at least in part, to relate to patient demographics. Beginning in 2010, we began offering a cobalt-chrome version of our PROFEMUR®

Table of Contents

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

modular neck, which has greater strength characteristics than the alternative titanium version. Historically, we have reflected our liability for these claims as part of our standard product liability accruals on a case-by-case basis. However, during the third quarter of 2011, as a result of an increase in the number and monetary amount of these claims, management estimated our liability to patients in North America who have previously required a revision following a fracture of a PROFEMUR® long titanium modular neck, or who may require a revision in the future. Management has estimated that this aggregate liability ranges from approximately $23 million to $37 million. Any claims associated with this product outside of North America, or for any other products, will be managed as part of our standard product liability accruals.

Due to the uncertainty within our aggregate range of loss resulting from the estimation of the number of claims and related monetary payments, we have recorded a liability of $23.3 million to be incurred over the next four years, which represents the low-end of our estimated aggregate range of loss. We have classified $4.7 million of this liability as current in “Accrued expenses and other current liabilities” and $18.6 million as non-current in “Other liabilities” on our condensed consolidated balance sheet. We expect to pay the majority of these claims within the next 4 years. We maintain insurance coverage, and thus have recorded an estimate of the probable recovery of approximately $4.0 million related to open claims within “Other current assets” and $7.4 million related to open claims within "Other assets" on our condensed consolidated balance sheet.

Claims for personal injury have also been made against us associated with our metal-on-metal hip products. The pre-trial management of certain of these claims has been consolidated in the federal court system under multi-district litigation, and certain other claims in state courts in California, as further discussed in Part I Item 3 of this Annual Report. The number of claims continues to increase, we believe due to the increasing negative publicity in the industry regarding metal-on-metal hip products. We believe we have data that supports the efficacy and safety of our metal-on-metal hip products, and we intend to vigorously defend ourselves in these matters. We are currently accounting for these claims in accordance with our standard product liability accrual methodology on a case by case basis. Management does not believe that the outcome of the currently reported claims will have a material adverse effect on our consolidated financial positions or results of operations. However, we are unable to estimate the impact of future potential claims.

Future revisions in our estimates of these provisions could materially impact our results of operations and financial position. We use the best information available to us in determining the level of accrued product liabilities, and we believe our accruals are adequate. We have maintained product liability insurance coverage on a claims-made basis. During the third quarter of 2012, we received a customary reservation of rights from our primary product liability insurance carrier asserting that certain present and future claims related to our CONSERVE® metal-on-metal hip products and which allege certain types of injury (CONSERVE® Claims) would be covered under the policy year the first such claim was asserted. The effect of this coverage position would be to place CONSERVE® Claims into a single prior policy year in which applicable claims-made coverage was available, subject to the overall policy limits then in effect. Management agrees that there is insurance coverage for the CONSERVE® Claims, but has notified the carrier that at this time it disputes the carrier's selection of available policy years.

Our products liability insurance coverage was renewed on August 15, 2012. However, the renewed policies contain an exclusion for loss arising out of all metal-on-metal hip replacement systems. This exclusion, for reasons explained above, does not affect coverage for future CONSERVE® Claims.

During the fourth quarter of 2012, we recorded a receivable of approximately $5.8 million for the probable insurance recovery of spending to date in excess of our aggregate retention in certain claim years. This spending primarily relates to defense and settlement costs associated with PROFEMUR® Claims and defense costs associated with CONSERVE® Claims. If our primary carrier were to assert that PROFEMUR® Claims fall under the policy year the first such claim was made, i.e., the same position as has been asserted for CONSERVE® Claims, then we would expect to recognize an additional insurance receivable and recover certain previously recorded defense and settlement

costs.

Our renewed products liability insurance policies contain an exclusion for loss arising out of PROFEMUR® long titanium modular necks. In the absence of any specific coverage position relating to PROFEMUR® Claims, we are unable to determine what effect, if any, the exclusion will have on coverage for any such future claims.

Employment Matters. In 2012, two former employees, Frank Bono and Alicia Napoli, each filed separate lawsuits against WMT in the Chancery Court of Shelby County, Tennessee, which asserted claims for retaliatory discharge and breach of contract based upon his or her respective separation pay agreement. In addition, Mr. Bono and Ms. Napoli each asserted a claim for defamation related to the press release issued at the time of their terminations and a wrongful discharge claim alleging violation of the Tennessee Public Protection Act. Mr. Bono and Ms. Napoli each claimed that he or she was entitled to attorney fees in addition to other unspecified damages.

Table of Contents

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

We are vigorously defending these lawsuits. Management does not believe that the outcome of these claims will have a material adverse effect on our consolidated financial position or results of operations.

Other. We have received claims from health care professionals following the termination of certain contractual arrangements and believe additional claims are possible. Management is unable to estimate the cost, if any, of ultimately resolving these claims. Accordingly, no provisions have been recorded in our financial statements related to these claims as of December 31, 2012.

In addition to those noted above, we are subject to various other legal proceedings, product liability claims, corporate governance, and other matters which arise in the ordinary course of business. In the opinion of management, the amount of liability, if any, with respect to these matters, will not materially affect our consolidated results of operations or financial position.

18. Segment Data

Until December 31, 2011, we operated our business as one operating segment, orthopaedics products, which included the design, manufacture and marketing of devices and biologic products for extremity, hip, and knee repair and reconstruction. During the first quarter of 2012, our management, including our chief executive officer, who is our chief operating decision maker, began managing our operations as two reportable business segments based on the two primary markets that we operate within: Extremities and OrthoRecon. The following information is presented as if we managed our operations as two segments for the years ended December 31, 2011 and 2010.

Our Extremities segment includes products that are used primarily in foot and ankle repair, upper extremity products, and biologics products, which are used to replace damaged or diseased bone, to stimulate bone growth and to provide other biological solutions for surgeons and their patients. Our OrthoRecon segment includes products that are used primarily to replace or repair knee, hip and other joints and bones that have deteriorated or have been damaged through disease or injury. The Corporate category shown in the table below primarily reflects general and administrative expenses not specifically associated with the Extremities or OrthoRecon segments.

Management measures segment profitability using an internal performance measure that excludes non-cash, stock-based compensation expense, restructuring charges, costs associated with the deferred prosecution agreement, charges associated with distributor conversions and related non-competes, due diligence and transaction costs, charges related to certain employee matters, changes in estimates associated with the Company's product liability provisions, and inventory step-up amortization associated with acquisitions. Assets in the OrthoRecon and Extremities segments are those assets used exclusively in the operations of each business segment or allocated when used jointly. Assets in the Corporate category are principally cash and cash equivalents, marketable securities, property, plant and equipment, and assets associated with income taxes.

Our geographic regions consist of the United States, Europe (which includes the Middle East and Africa) and Other (which principally represents Latin America, Asia, Australia and Canada). Long-lived assets are those assets located in each region. Revenues attributed to each region are based on the location in which the products were sold.

Table of Contents

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

Net sales of orthopaedic products by product line and information by geographic region are as follows (in thousands):

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| OrthoRecon | | | |
| Hip | $150,550 | $173,201 | $176,687 |
| Knees | 114,896 | 123,988 | 128,854 |
| Other | 4,225 | 5,005 | 4,943 |
| Total OrthoRecon | 269,671 | 302,194 | 310,484 |
| | | | |
| Extremities | | | |
| Foot and Ankle | 122,897 | 107,734 | 97,971 |
| Upper Extremity | 24,977 | 27,742 | 26,519 |
| Biologics | 60,495 | 69,409 | 79,231 |
| Other | 5,736 | 5,868 | 4,768 |
| Total Extremities | 214,105 | 210,753 | 208,489 |
| | | | |
| Total Sales | $483,776 | $512,947 | $518,973 |

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| United States | $275,686 | $295,944 | $309,983 |
| Europe | 92,750 | 100,739 | 102,431 |
| Other | 115,340 | 116,264 | 106,559 |
| Total | $483,776 | $512,947 | $518,973 |

| | December 31, | |
|---|---|---|
| | 2012 | 2011 |
| Long-lived assets: | | |
| United States | $114,576 | $131,745 |
| Europe | 9,644 | 12,226 |
| Other | 14,022 | 16,313 |
| Total | $138,242 | $160,284 |

Our subsidiary in Japan represented approximately 12%, 13%, and 11% of our total net sales in 2012, 2011, and 2010, respectively. No other single foreign country accounted for more than 10% of our total net sales during 2012, 2011, or 2010.

Table of Contents

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

Selected financial information related to our segments is presented below for the years ended December 31, 2012, 2011 and 2010 (in thousands):

| | Year ended December 31, 2012 | | | |
|---|---|---|---|---|
| | OrthoRecon | Extremities | Corporate | Total |
| Sales | $269,671 | $214,105 | $— | $483,776 |
| Depreciation expense | 23,928 | 11,386 | 2,961 | 38,275 |
| Amortization expense | 334 | 2,409 | — | 2,743 |
| Segment operating income | 33,527 | 49,481 | (51,129) | 31,879 |
| Other: | | | | |
| Non-cash, stock-based compensation | | | | (10,974) |
| Gain on sale of intellectual property | | | | 15,000 |
| DPA related | | | | (6,593) |
| Restructuring charges | | | | (1,588) |
| Due diligence and transaction costs | | | | (1,798) |
| Product liability insurance recovery for previously recognized defense costs | | | | 2,432 |
| Distributor conversion charges | | | | (4,056) |
| Inventory step-up amortization | | | | (158) |
| Operating income | | | | 24,144 |
| Interest expense, net | | | | 10,188 |
| Other expense, net | | | | 5,395 |
| Income before income taxes | | | | $8,561 |
| Capital expenditures | $5,582 | $7,056 | $6,685 | $19,323 |
| Total Assets | $280,594 | $196,737 | $476,122 | $953,453 |

| | Year ended December 31, 2011 | | | |
|---|---|---|---|---|
| | OrthoRecon | Extremities | Corporate | Total |
| Sales | $302,194 | $210,753 | $— | $512,947 |
| Depreciation expense | 26,070 | 10,876 | 3,281 | 40,227 |
| Amortization expense | 458 | 2,412 | — | 2,870 |
| Segment operating income | 60,895 | 46,989 | (49,139) | 58,745 |
| Other: | | | | |
| Non-cash, stock-based compensation | | | | (9,108) |
| DPA related | | | | (12,920) |
| Restructuring charges | | | | (16,876) |
| Employment matters | | | | (2,017) |
| Product liability provision | | | | (13,199) |
| Inventory step-up amortization | | | | (32) |
| Operating income | | | | 4,593 |
| Interest expense, net | | | | 6,529 |
| Other expense, net | | | | 4,719 |
| Loss before income taxes | | | | $(6,655) |
| Capital expenditures | $19,031 | $12,926 | $15,000 | $46,957 |
| Total Assets | $303,018 | $191,718 | $259,844 | $754,580 |

90

Table of Contents

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

| | Year ended December 31, 2010 | | | |
|---|---|---|---|---|
| | OrthoRecon | Extremities | Corporate | Total |
| Sales | $310,484 | $208,489 | $— | $518,973 |
| Depreciation expense | 24,793 | 8,723 | 2,043 | 35,559 |
| Amortization expense | 313 | 2,398 | — | 2,711 |
| Segment operating income | 55,295 | 44,700 | (37,823) | 62,172 |
| Other: | | | | |
| Non-cash, stock-based compensation | | | | (13,177) |
| DPA related | | | | (10,902) |
| Restructuring charges | | | | (919) |
| Operating income | | | | 37,174 |
| Interest expense, net | | | | 6,123 |
| Other expense, net | | | | 130 |
| Income before taxes | | | | $30,921 |
| Capital expenditures | $27,492 | $12,846 | $8,700 | $49,038 |
| Total Assets | $306,245 | $180,868 | $268,126 | $755,239 |

Table of Contents

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

19. Quarterly Results of Operations (unaudited):

The following table presents a summary of our unaudited quarterly operating results for each of the four quarters in 2012 and 2011, respectively (in thousands). This information was derived from unaudited interim financial statements that, in the opinion of management, have been prepared on a basis consistent with the financial statements contained elsewhere in this filing and include all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of such information when read in conjunction with our audited financial statements and related notes. The operating results for any quarter are not necessarily indicative of results for any future period.

| | 2012 | | | |
|---|---|---|---|---|
| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
| Net sales | $126,656 | $123,280 | $110,363 | $123,477 |
| Cost of sales | 36,806 | 38,434 | 35,089 | 39,649 |
| Cost of sales - restructuring | 435 | — | — | — |
| Gross profit | 89,415 | 84,846 | 75,274 | 83,828 |
| Operating expenses: | | | | |
| Selling, general and administrative | 72,348 | 72,862 | 70,851 | 74,200 |
| Research and development | 6,221 | 6,744 | 6,612 | 7,456 |
| Amortization of intangible assets | 742 | 1,254 | 1,827 | 1,949 |
| Gain on sale of intellectual property | — | — | — | (15,000) |
| Restructuring charges | 443 | 710 | — | — |
| Total operating expenses | 79,754 | 81,570 | 79,290 | 68,605 |
| Operating income (loss) | $9,661 | $3,276 | $(4,016) | $15,223 |
| Net income (loss) | $4,561 | $710 | $(5,339) | $5,352 |
| Net income (loss) per share, basic | $0.12 | $0.02 | $(0.14) | $0.14 |
| Net income (loss) per share, diluted | $0.12 | $0.02 | $(0.14) | $0.14 |

| | 2011 | | | |
|---|---|---|---|---|
| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
| Net sales | $135,386 | $132,505 | $118,184 | $126,872 |
| Cost of sales | 38,768 | 41,504 | 36,185 | 40,449 |
| Cost of sales - restructuring | — | — | 1,900 | 571 |
| Gross profit | 96,618 | 91,001 | 80,099 | 85,852 |
| Operating expenses: | | | | |
| Selling, general and administrative | 74,825 | 70,821 | 83,581 | 72,361 |
| Research and development | 9,207 | 7,807 | 6,769 | 6,331 |
| Amortization of intangible assets | 690 | 677 | 721 | 782 |
| Restructuring charges | — | — | 12,132 | 2,273 |
| Total operating expenses | 84,722 | 79,305 | 103,203 | 81,747 |
| Operating income (loss) | $11,896 | $11,696 | $(23,104) | $4,105 |
| Net income (loss) | $3,592 | $6,147 | $(16,045) | $1,163 |
| Net income (loss) per share, basic | $0.09 | $0.16 | $(0.42) | $0.03 |
| Net income (loss) per share, diluted | $0.09 | $0.16 | $(0.42) | $0.03 |

Our operating income in 2012 included charges related to the U.S. government inquiries, for which we recognized $2.9 million, $2.1 million, $1.7 million, and a gain of $0.1 million during the first, second, third and fourth quarters of 2012, respectively. In addition, our operating income during the first and second quarters of 2012 included $0.9 million and $0.7 million of restructuring charges related to our cost improvement measures. We recognized $0.8 million, $1.6 million, and $1.7 million in the second, third, and fourth quarters of 2012, respectively, for costs associated with distributor conversions and non-competes. In the fourth quarter of 2012, we recognized $1.8 million for due diligence and transaction costs and a $2.4 million gain for the adjustment to management's estimate associated with our product liability provisions. Net income in 2012 included the after-tax effect of these

Table of Contents

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

amounts. In the third and fourth quarters of 2012, net income includes the after tax effects of $0.7 million and $2.1 million non-cash interest expense related to our 2017 Convertible Notes, respectively. Additionally, net income in the third quarter of 2012 includes the after tax effects of $1.8 million loss for the termination of a derivative instrument, $2.7 million charge for the write-off of unamortized deferred financing costs, and $2.3 million gain for mark-to-market adjustments on derivative assets and liabilities. Net income in the fourth quarter of 2012 includes the after tax effects of a $15 million gain on the sale of assets and a $3.5 million loss for mark-to-market adjustments on derivative assets and liabilities.

Our operating income in 2011 included charges related to the U.S. government inquiries, for which we recognized $2.2 million, $2.4 million, $5.0 million, and $3.4 million during the first, second, third and fourth quarters of 2011, respectively. In addition, our operating income during the third and fourth quarters of 2011 included $14.0 million and $2.8 million of restructuring charges related to our cost improvement measures and, in the third quarter of 2011, included $13.2 million of charges related to the recognition of management estimate of our total liability for claims associated with previous and estimated future fractures of our PROFEMUR® long necks in North America. Net income in 2011 included the after-tax effect of these amounts and in the first quarter of 2011, the after-tax effects of approximately $4.1 million of expenses recognized for the write off of pro-rata unamortized deferred financing fees.

20. Subsequent Event

On January 7, 2013, we completed the acquisition of WG Healthcare Limited, a UK company, for approximately $6.8 million. We acquired the facility, inventory, infrastructure and all other assets associated with the company's foot and ankle business. The two former owners of WG Healthcare Limited have joined Wright Medical as full time employees effective immediately.

Table of Contents

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.
Not applicable.

Item 9A. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

We have established disclosure controls and procedures, as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934. Our disclosure controls and procedures are designed to ensure that material information relating to us, including our consolidated subsidiaries, is made known to our principal executive officer and principal financial officer by others within our organization. Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our disclosure controls and procedures as of December 31, 2012 to ensure that the information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is accumulated and communicated to our management, including our principal executive officer and principal financial officer as appropriate, to allow timely decisions regarding required disclosure. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective as of December 31, 2012.

Management's Annual Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2012, based on the criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this evaluation, our management concluded that our internal control over financial reporting was effective as of December 31, 2012. Our internal control over financial reporting as of December 31, 2012, has been audited by KPMG LLP, an independent registered public accounting firm, as stated in their report which is included herein.

Changes in Internal Control Over Financial Reporting

During the three months ended December 31, 2012, there were no changes in our internal control over financial reporting that materially affected, or that are reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information.
Not applicable.

Table of Contents

PART III

Item 10. Directors, Executive Officers and Corporate Governance.
The information required by this item is incorporated by reference from the definitive proxy statement to be filed within 120 days after December 31, 2012, pursuant to Regulation 14A under the Securities Exchange Act of 1934 in connection with the annual meeting of stockholders to be held on May 14, 2013.

Item 11. Executive Compensation.
The information required by this item is incorporated by reference from the definitive proxy statement to be filed within 120 days after December 31, 2012, pursuant to Regulation 14A under the Securities Exchange Act of 1934 in connection with the annual meeting of stockholders to be held on May 14, 2013.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.
The information required by this item is incorporated by reference from the definitive proxy statement to be filed within 120 days after December 31, 2012, pursuant to Regulation 14A under the Securities Exchange Act of 1934 in connection with the annual meeting of stockholders to be held on May 14, 2013.

Item 13. Certain Relationships and Related Transactions, and Director Independence.
The information required by this item is incorporated by reference from the definitive proxy statement to be filed within 120 days after December 31, 2012, pursuant to Regulation 14A under the Securities Exchange Act of 1934 in connection with the annual meeting of stockholders to be held on May 14, 2013.

Item 14. Principal Accountant Fees and Services.
The information required by this item is incorporated by reference from the definitive proxy statement to be filed within 120 days after December 31, 2012, pursuant to Regulation 14A under the Securities Exchange Act of 1934 in connection with the annual meeting of stockholders to be held on May 14, 2013.

Table of Contents

PART IV

Item 15. Exhibits and Financial Statement Schedules.

Financial Statements

See Index to Consolidated Financial Statements in “Financial Statements and Supplementary Data.”

Financial Statement Schedules

See Schedule II — Valuation and Qualifying Accounts on page S-1 of this report.

Index to Exhibits

| Exhibit No. | Description |
|---|---|
| 3.1 | Fourth Amended and Restated Certificate of Incorporation of Wright Medical Group, Inc., (1) as amended by Certificate of Amendment of Fourth Amended and Restated Certificate of Incorporation of Wright Medical Group, Inc. (2) |
| 3.2 | Second Amended and Restated By-laws of Wright Medical Group, Inc. (3) |
| 4.1 | Form of Common Stock certificate. (1) |
| 4.2 | Indenture, dated as of November 26, 2007, between Wright Medical Group, Inc. and The Bank of New York as trustee (including form of 2.625% Convertible Senior Notes due 2014). (4) |
| 4.3 | Underwriting Agreement, dated as of November 19, 2007, among Wright Medical Group, Inc. and J.P. Morgan Securities Inc., Piper Jaffray & Co. and Wachovia Capital Markets, LLC. (4) |
| 4.4 | Indenture, dated as of August 31, 2012, between Wright Medical Group, Inc. and The Bank of New York, as trustee (including form of 2.000% Cash Convertible Senior Notes due 2017).(24) |
| 4.5 | Purchase Agreement, dated as of August 22, 2012, among Wright Medical Group, Inc. and J.P. Morgan Securities LLC, as Representative of the Initial Purchasers. (23) |
| 10.1 | Credit Agreement dated as of February 10, 2011, among Wright Medical Group, Inc., as the Borrower; the U.S. subsidiaries of the Borrower, as the Guarantors; the Lenders named therein; Bank of America, N.A., as Administrative Agent, Swing Line Lender and L/C Issuer; SunTrust Bank and Wells Fargo Bank, N.A., as Co-Syndication Agents; and US Bank National Association, as Documentation Agent. (16) |
| 10.2* | Fifth Amended and Restated 1999 Equity Incentive Plan (the 1999 Plan), (6) as amended by First Amendment to the 1999 Plan. (7) |
| 10.3* | Amended and Restated 2009 Equity Incentive Plan (2009 Plan) (8) |
| 10.4* | Form of Executive Stock Option Agreement pursuant to the 2009 Plan. |
| 10.5* | Form of Non-US Employee Stock Option Agreement pursuant to the 2009 Plan. |
| 10.6* | Form of Non-Employee Director Stock Option Agreement (one year vesting) pursuant to the 2009 Plan. |
| 10.7* | Form of Non-Employee Director Stock Option Agreement (four year vesting) pursuant to the 2009 Plan. |
| 10.8* | Form of Executive Restricted Stock Grant Agreement pursuant to the 2009 Plan. |

| | |
|---|---|
| 10.9* | Form of Non-Employee Director Restricted Stock Grant Agreement (one year vesting) pursuant to the 2009 Plan. |
| 10.10* | Form of Non-Employee Director Restricted Stock Grant Agreement (four year vesting) pursuant to the 2009 Plan. |
| 10.11* | Form of Non-US Employee Restricted Stock Unit Grant Agreement pursuant to the 2009 Plan. |
| 10.12* | Form of Executive Stock Option Agreement pursuant to the 1999 Plan. (9) |
| 10.13* | Form of Non-US Employee Stock Option Agreement pursuant to the 1999 Plan. (9) |
| 10.14* | Form of Non-Employee Director Stock Option Agreement (one year vesting) pursuant to the 1999 Plan. (9) |
| 10.15* | Form of Non-Employee Director Stock Option Agreement (four year vesting) pursuant to the 1999 Plan. (9) |
| 10.16* | Form of Executive Restricted Stock Grant Agreement pursuant to the 1999 Plan. (9) |
| 10.17* | Form of Non-US Employee Phantom Stock Unit Grant Agreement pursuant to the 1999 Plan. (9) |

Table of Contents

| | |
|---|---|
| 10.18* | Form of Non-Employee Director Restricted Stock Grant Agreement (four year vesting) pursuant to the 1999 Plan.(10) |
| 10.19* | Wright Medical Group, Inc. Executive Performance Incentive Plan. (11) |
| 10.20* | Wright Medical Group, Inc. 2010 Executive Performance Incentive Plan. (12) |
| 10.21* | Form of Indemnification Agreement between Wright Medical Group, Inc. and its directors and executive officers. (13) |
| 10.22* | Separation Pay Agreement dated as of November 6, 2012 between Wright Medical Technology, Inc. and Lance A. Berry. (14) |
| 10.23* | Separation Pay Agreement dated as of November 6, 2012 between Wright Medical Technology, Inc. and William L. Griffin, Jr. (14) |
| 10.24* | Separation Pay Agreement dated as of November 6, 2012 between Wright Medical Technology, Inc. and Eric A. Stookey.(14) |
| 10.25* | Separation Pay Agreement dated as of November 6, 2012 between Wright Medical Technology, Inc. and Daniel J. Garen. |
| 10.26* | Employment Agreement dated as of September 17, 2011 between Wright Medical Technology, Inc. and Robert J. Palmisano. (19) |
| 10.27* | Separation Pay Agreement dated as of November 6, 2012 between Wright Medical Technology, Inc. and Timothy E. Davis, Jr. (14) |
| 10.28* | Separation Pay Agreement dated as of November 29, 2012 between Wright Medical Technology, Inc. and Pascal E.R. Girin. |
| 10.29* | Inducement Stock Option Grant Agreement dated as of September 17, 2011 between Wright Medical Technology, Inc. and Robert J. Palmisano. (19) |
| 10.30* | Inducement Stock Option Grant Agreement between the Registrant and Julie D. Tracy dated October 17, 2011. (20) |
| 10.31* | Inducement Stock Option Grant Agreement between Registrant and James A. Lightman dated December 29, 2011(20) |
| 10.32* | Inducement Stock Option Grant Agreement between Registrant and Daniel Garen dated January 30, 2012. (20) |
| 10.33* | Inducement Stock Option Grant Agreement between Registrant and Pascal E.R. Girin dated November 26, 2012. |
| 10.34 | Settlement Agreement dated September 29, 2010, among the United States of America, acting through the United States Department of Justice and on behalf of the Office of Inspector General of the Department of Health and Human Services, and Wright Medical Technology, Inc. (15) |

| | |
|---|---|
| 10.35 | Corporate Integrity Agreement dated September 29, 2010, between Wright Medical Technology, Inc. and the Office of Inspector General of the Department of Health and Human Services. (15) |
| 10.36 | Deferred Prosecution Agreement dated September 29, 2010, between Wright Medical Technology, Inc. and the United States Attorney's Office for the District of New Jersey.(15) |
| 10.37 | Amendment to the Corporate Integrity Agreement dated September 14, 2011, between Wright Medical Technology, Inc. and the Office of Inspector General of the Department of Health and Human Services. (18) |
| 10.38 | Addendum and Amendment to the Deferred Prosecution Agreement dated September 15, 2011, between Wright Medical Technology, Inc. and the United States Attorney's Office for the District of New Jersey. (18) |
| 10.39† | Amended and Restated Supply and Development Agreement dated January 28, 2011 between Wright Medical Technology, Inc. and LifeCell Corporation. (17) |
| 10.40† | Trademark License Agreement dated January 28, 2011 between Wright Medical Technology, Inc. and KCI Medical Records. (17) |
| 10.41 | Base Call Option Transaction Confirmation, dated as of August 23, 2012, between Wright Medical Group, Inc. and Bank of America, N.A. (21) |
| 10.42 | Base Call Option Transaction Confirmation, dated as of August 23, 2012, between Wright Medical Group, Inc. and Deutsche Bank AG, London Branch, through its agent Deutsche Bank Securities Inc. (21) |
| 10.43 | Base Call Option Transaction Confirmation, dated as of August 23, 2012, between Wright Medical Group, Inc., and Wells Fargo Bank, National Association through its agent Wells Fargo Securities, LLC (21) |

Table of Contents

| | |
|---|---|
| 10.44 | Base Warrants Confirmation, dated as of August 23, 2012, between Wright Medical Group, Inc. and Bank of America, N.A. (21) |
| 10.45 | Base Warrants Confirmation, dated as of August 23, 2012, between Wright Medical Group, Inc. and Deutsche Bank AG, London Branch, through its agent Deutsche Bank Securities Inc. (21) |
| 10.46 | Base Warrants Confirmation, dated as of August 23, 2012, between Wright Medical Group, Inc. and Wells Fargo Bank, National Association through its agent Wells Fargo Securities, LLC (21) |
| 10.47 | Additional Call Option Transaction Confirmation, dated as of August 28, 2012, between Wright Medical Group, Inc. and Bank of America, N.A. (22) |
| 10.48 | Additional Call Option Transaction Confirmation, dated as of August 28, 2012, between Wright Medical Group, Inc. and Deutsche Bank AG, London Branch, through its agent Deutsche Bank Securities Inc. (22) |
| 10.49 | Additional Call Option Transaction Confirmation, dated as of August 28, 2012, between Wright Medical Group, Inc. and Wells Fargo Bank, National Association through its agent Wells Fargo Securities, LLC (22) |
| 10.50 | Additional Warrants Confirmation, dated as of August 28, 2012, between Wright Medical Group, Inc. and Bank of America, N.A. (22) |
| 10.51 | Additional Warrants Confirmation, dated as of August 28, 2012, between Wright Medical Group, Inc. and Deutsche Bank AG, London Branch, through its agent Deutsche Bank Securities Inc. (22) |
| 10.52 | Additional Warrants Confirmation, dated as of August 28, 2012, between Wright Medical Group, Inc. and Wells Fargo Bank, National Association through its agent Wells Fargo Securities, LLC (22) |
| 10.53†† | Supply Agreement, dated as of November 2, 2012, by and between Wright Medical Technologies, Inc. and Orchid MPS Holdings, LLC |
| 11 | Computation of earnings per share (included in Note 13 of the Notes to Consolidated Financial Statements in “Financial Statements and Supplementary Data”). |
| 12 | Ratio of Earnings to Fixed Charges. |
| 14 | Code of Ethics. (5) |
| 21 | Subsidiaries of Wright Medical Group, Inc. |

| | |
|---|---|
| 23 | Consent of KPMG LLP. |
| 31.1 | Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) Under the Securities Exchange Act of 1934. |
| 31.2 | Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) Under the Securities Exchange Act of 1934. |
| 32 | Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Rule 13a-14(b) Under the Securities Exchange Act of 1934 and Section 1350 of Chapter 63 of Title 18 of the United States Code. |
| 101 | The following materials from Wright Medical Group, Inc. Annual Report on Form 10-K for the year ended December 31, 2012 formatted in XBRL (Extensible Business Reporting Language): (1) the Consolidated Balance Sheets, (2) Parenthetical Data to the Consolidated Balance Sheets, (3) the Consolidated Statements of Operations, (4) Parenthetical Data to the Consolidated Statements of Operations, (5) the Consolidated Statements of Comprehensive Income, (6) the Consolidated Statements of Cash Flows (7) the Consolidated Statements of Changes in Stockholders' Equity and (7) Notes to Consolidated Financial Statements. |

(1) Incorporated by reference to our Registration Statement on Form S-1 (Registration No. 333-59732), as amended.
(2) Incorporated by reference to our Registration Statement on Form S-8 filed on May 14, 2004.
(3) Incorporated by reference to our current report on Form 8-K filed on February 19, 2008.
(4) Incorporated by reference to our current report on Form 8-K filed on November 26, 2007.
(5) Incorporated by reference to our current report on Form 8-K filed July 8, 2011.
(6) Incorporated by reference to our definitive Proxy Statement filed on April 14, 2008.
(7) Incorporated by reference to our quarterly report on Form 10-Q for the quarter ended September 30, 2008.
(8) Incorporated by reference to our definitive Proxy Statement filed on April 15, 2010.
(9) Incorporated by reference to our quarterly report on Form 10-Q for the quarter ended June 30, 2009.
(10) Incorporated by reference to our Registration Statement on Form S-8 filed on June 18, 2008.
(11) Incorporated by reference to our current report on Form 8-K filed on February 10, 2005.

Table of Contents

(12) Incorporated by reference to our current report on Form 8-K filed on March 25, 2010.
(13) Incorporated by reference to our current report on Form 8-K filed on April 7, 2009.
(14) Incorporated by reference to our current report on Form 8-K filed on November 6, 2012.
(15) Incorporated by reference to our current report on Form 8-K filed on September 30, 2010.
(16) Incorporated by reference to our annual report on Form 10-K for the fiscal year ended December 31, 2010.
(17) Incorporated by reference to our current report on Form 8-K/A filed on May 18, 2011.
(18) Incorporated by reference to our current report on Form 8-K filed September 15, 2011.
(19) Incorporated by reference to our current report on Form 8-K filed on September 22, 2011.
(20) Incorporated by reference to our annual report on Form 10-K for the fiscal year ended December 31, 2011.
(21) Incorporated by reference to our current report on Form 8-K filed on August 28, 2012.
(22) Incorporated by reference to our current report on Form 8-K filed on September 4, 2012.
* Denotes management contract or compensatory plan or arrangement.
† Confidential treatment granted under 17 CFR 24b-2. The confidential portions of this exhibit have been omitted and are marked accordingly. The confidential portions have been filed separately with the Securities and Exchange Commission pursuant to the Confidential Treatment Request.
†† Confidential treatment requested under 17 CFR 24b-2. The confidential portions of this exhibit have been omitted and are marked accordingly. The confidential portions have been filed separately with the Securities and Exchange Commission pursuant to the Confidential Treatment Request.

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

February 21, 2013

Wright Medical Group, Inc.

By: /s/ Robert J. Palmisano
Robert J. Palmisano
President and Chief Executive Officer

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

| Signature | Title | Date |
|---|---|---|
| /s/ Robert J. Palmisano<br>Robert J. Palmisano | President, Chief Executive Officer and Director<br>(Principal Executive Officer) | February 21, 2013 |
| /s/ Lance A. Berry<br>Lance A. Berry | Chief Financial Officer<br>(Principal Financial Officer ) | February 21, 2013 |
| /s/ Julie B. Andrews<br>Julie B. Andrews | Chief Accounting Officer<br>(Principal Accounting Officer ) | February 21, 2013 |
| /s/ David D. Stevens<br>David D. Stevens | Director | February 21, 2013 |
| /s/ Gary D. Blackford<br>Gary D. Blackford | Director | February 21, 2013 |
| /s/ Martin J. Emerson<br>Martin J. Emerson | Director | February 21, 2013 |
| /s/ Lawrence W. Hamilton<br>Lawrence W. Hamilton | Director | February 21, 2013 |
| /s/ Ronald K. Labrum<br>Ronald K. Labrum | Director | February 21, 2013 |
| /s/ John L. Miclot<br>John L. Miclot | Director | February 21, 2013 |

| | | |
|---|---|---|
| /s/ Amy S. Paul<br>Amy S. Paul | Director | February 21, 2013 |
| /s/ Robert J. Quillinan<br>Robert J. Quillinan | Director | February 21, 2013 |

Table of Contents

Report of Independent Registered Public Accounting Firm
The Board of Directors and Stockholders

Wright Medical Group, Inc.:

Under date of February 21, 2013, we reported on the consolidated balance sheets of Wright Medical Group, Inc. and subsidiaries (the Company) as of December 31, 2012 and 2011, and the related consolidated statements of operations, changes in stockholders' equity, comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2012. These consolidated financial statements, and our report thereon, are included in the annual report on Form 10–K for the year ended December 31, 2012. In connection with our audits of the aforementioned consolidated financial statements, we also audited the related financial statement schedule listed in Item 15 in the annual report on Form 10-K. The financial statement schedule is the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statement schedule based on our audits.

In our opinion, the financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

(signed) KPMG LLP
Memphis, Tennessee
February 21, 2013

Table of Contents

Wright Medical Group, Inc.
Schedule II-Valuation and Qualifying Accounts
(In thousands)

| | Balance at Beginning of Period | Charged to Cost and Expenses | Deductions and Other | Balance at End of Period |
|---|---|---|---|---|
| Allowance for doubtful accounts: | | | | |
| For the period ended: | | | | |
| December 31, 2012 | $8,505 | $(104) | $232 | $8,633 |
| December 31, 2011 | $9,464 | $622 | $(1,581) | $8,505 |
| December 31, 2010 | $8,644 | $1,073 | $(253) | $9,464 |
| Sales returns and allowance: | | | | |
| For the period ended: | | | | |
| December 31, 2012 | $513 | $(61) | $— | $452 |
| December 31, 2011 | $563 | $(50) | $— | $513 |
| December 31, 2010 | $551 | $12 | $— | $563 |

S-1