



Unaudited Interim Condensed Consolidated

Financial Statements

As of June 30, 2008

Synthes, Inc. and subsidiaries
Unaudited Interim Condensed Consolidated Financial Statements

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Synthes First Half 2008 Earnings Growth Exceeds Double-Digit Local Currency Sales Growth

West Chester (PA), USA, July 30, 2008

Synthes (SWX: SYST.VX) today announced its First Half Year 2008 financial results, with sales and earnings growth of 18.1% and 23.6%, respectively (12.6% and 16.9%, respectively, in local currencies). Net earnings growth exceeded organic double-digit sales growth.

Second Quarter 2008

- **Consolidated sales** increased by 17.5% (11.9% in local currencies) over prior year to US\$ 792.5 million
- **Double-digit sales growth** was achieved in all geographical regions and divisions
- Commitment to the introduction of **new products** and **continued sales force expansion**, including investments in equipment and education, contributed to positive results
- **ProDisc®-C** received further coverage for reimbursement by several key insurers in the US
- **In-Space interspinous spacer** pilot FDA IDE study was initiated in the US

First Half Year 2008

- **Consolidated sales** increased by 18.1% (12.6% in local currencies) over prior year to US\$ 1,573.5 million
- **Net earnings** of US\$ 348.8 million represent an increase of 23.6% (16.9% in local currencies) vs. prior year, once again exceeding double-digit sales growth
- Strong growth was achieved across the company, with accelerated performance in **Asia Pacific**
- **Gross margin** of 83.3% increased by 1.6 percentage points (pps) vs. prior year
- **Operating expenses** as a percentage of sales remained flat vs. prior year
- **Foreign exchange** transaction losses negatively impacted "Other Income/(Expense)" and "Royalty Expense"
- **Income tax rate** decreased by 2.4 pps vs. prior year
- **Strong cash generation** was offset by payments related to acquisitions, FIN 48 tax statute and increased working capital (which is primarily a result of foreign currency translation)
- **Other highlights** included the launch of **ProDisc®-C**, the **Innomedic** acquisition, and the settlement of the **TFN (Trochanteric Fixation Nail)** case

Michel Orsinger, President and CEO of Synthes, comments on the performance:

"We are pleased to have delivered another strong half year of growth that spans all regions and divisions. Our improved profitability is also an important achievement, as it is the direct result of gross margin gains from increased short-term production volumes and enhanced operational efficiencies combined with new product introductions from our rich product pipeline."

REGIONAL PERFORMANCE (Second Quarter 2008)

North America achieved double-digit sales growth during the second quarter. Trauma continued to grow above market at a double-digit pace. Spine experienced strong performance due to new product introductions and accelerated sales force expansion.

The **Synthes Resident Program (SRP)**, an on-line training platform for entry-level surgeons, was expanded from Trauma to other divisions in the US. The program has been highly successful with more than 90% of US orthopedic residents enrolled. The SRP will be launched outside the US later in 2008.

The **Synthes Inventory Management System (SIMS)** has achieved a high level of penetration as a state-of-the-art logistical support system for hospitals.

Europe realized solid sales growth as a result of sales force expansions during 2007 and the First Half 2008. CMF performance was especially strong primarily due to the introduction of mandibular distraction, neurosurgical and cardiothoracic products. On a country basis, the UK, Russia, and Poland realized significant gains over the previous year.

Asia Pacific achieved attractive double-digit gains in all divisions, primarily in China and Korea. Strong growth was achieved despite a government mandated price decrease in Japan which took effect during the quarter. The Asia-specific PFNA (Proximal Femoral Nail) and LCP (Locking Compression Plate) product lines continued to support strong growth for the region.

Additionally, several key management positions in Asia Pacific were filled during the quarter.

In **Rest of World**, growth was positively impacted by the first shipments of a tender order to the Middle East. Latin America also grew at a double-digit rate.

FINANCIAL PERFORMANCE (First Half Year 2008)

2008 first half year **gross profit margin** of 83.3% (as a percentage of sales) improved versus first half year 2007 of 81.7% due to favorable sales mix, increased levels of production (including short-term Middle East tender volumes, which improved overhead absorption) and manufacturing productivity initiatives.

Operating expense remained flat (as a percentage of sales) versus prior year as a result of productivity improvements which helped offset increased investments in the business to support sales force expansion, education, and research and development efforts. Higher royalty expenses (as a percentage of sales) resulted from the weakened US dollar.

Other Income (Expense) was negatively impacted by foreign exchange losses, primarily a result of the strengthening Swiss Franc.

Improvements in the **income tax rate** were achieved due to tax planning efforts and favorable outcomes on certain tax contingencies.

Net earnings growth exceeded sales growth despite the impact of first half 2008 foreign exchange losses.

Synthes' investments in its future growth were reflected by **Capital Expenditures** of US\$ 126.5 million, including sales force equipment investments (implant and instrument kits) of US\$ 93.9 million, an increase of 53% versus prior year. The increase in sales force investments can be attributed to our continued commitment to sales force expansion and new product launches.

During the first half 2008, Synthes increased its staffing by more than 500 employees, approximately 80% of which were sales force and manufacturing personnel. On June 30, 2008 Synthes employed **9,617 employees** worldwide.

PRODUCT GROUP DEVELOPMENTS (Second Quarter 2008)

TRAUMA

Trauma achieved double-digit sales growth globally, fueled by increased sales of the **Trochanteric Fixation Nail (TFN)** and the continued success of the **LCP (Locking Compression Plate)** platform, including the **LCP Volar Column Distal Radius Plate**.

A key new Trauma product launch at the end of the second quarter was the **Variable Angle LCP Extra-Articular Distal Radius Plate**, an innovative system for the treatment of wrist fractures, which are one of the most common types of fractures. This is Synthes' first plating system to utilize variable angle LCP technology, which combines the benefits of locked plating with the intraoperative flexibility of multiple screw angulations.

Close to twenty **Synthes Geriatric Fracture Centers** (hospitals) are now fully operational both in the US and in Europe. Synthes aids in establishing the centers by providing them with comprehensive protocols and standardized procedures that significantly reduce total treatment times and improve the care of geriatric fracture patients.

SPINE

Spine's accelerated growth continued to be driven by **SynFix-LR** and **Synapse**, while the **OPAL Spacer** also was a strong contributor. SynFix-LR, with its unique plate/spacer combination and anterior-only access, continued to gain clinical acceptance. Synapse is a comprehensive set of implants and instruments for stabilization of the upper spine. The OPAL Spacer is a vertebral body replacement device intended for use in the thoracolumbar spine.

ProDisc®-C Total Disc Replacement made progress with reimbursement in the US as several key payors announced positive coverage decisions for cervical total disc arthroplasty.

In June, the first surgeries of the pilot US FDA IDE clinical study for **In-Space** were completed. In-Space is a motion-preserving implant designed to treat lumbar spinal stenosis through a minimally-invasive lateral approach.

Spine's product portfolio was bolstered by several significant product launches, including **Zero-P** (a zero-profile plate/spacer combination for standalone cervical interbody fusion), **N-Hance** (acquired in December 2007 from N Spine) and the **Constellation Cannulated Pangea**, which is used as a minimally-invasive treatment system for pedicle screw fixations.

CMF

The CMF division continued to grow above market, driven by increased sales of its Matrix product lines. They include **MatrixNEURO**, a cranial plating system that offers a complete line of plates, screws and instrumentation designed specifically for neurosurgical fixation, and **MatrixMIDFACE**, a comprehensive plating system for the midface and craniofacial skeleton launched in January 2008.

CMF's Europe and Asia Pacific operations continued to post attractive double-digit growth rates.

OUTLOOK

For the second half of 2008, Synthes continues to expect **low double-digit sales growth in local currency**. Synthes will maintain its focus on continuous rollout and clinical acceptance of new products, the expansion of the global sales force, and educational programs for surgeons and operating room personnel.

Synthes, Inc. and subsidiaries
Condensed Consolidated Balance Sheets
As of June 30, 2008, December 31, 2007 and June 30, 2007

| | (Unaudited) June 30, 2008 <i>in 1,000 US\$</i> | Dec. 31, 2007 <i>in 1,000 US\$</i> | (Unaudited) June 30, 2007 <i>in 1,000 US\$</i> |
|---|--|---------------------------------------|--|
| Assets | | | |
| Current Assets | | | |
| Cash and cash equivalents | 553,251 | 544,882 | 298,869 |
| Accounts receivable | | | |
| Trade | 563,338 | 504,338 | 475,411 |
| Less Trade allowance | (22,185) | (21,111) | (14,113) |
| Other | 61,303 | 44,526 | 51,488 |
| Inventories, net | 486,540 | 439,978 | 475,497 |
| Prepaid expenses and other current assets | 49,205 | 41,688 | 37,469 |
| Deferred income taxes | 34,705 | 34,090 | 27,800 |
| Total current assets | 1,726,157 | 1,588,391 | 1,352,421 |
| Property, plant and equipment, net | 653,638 | 603,362 | 563,565 |
| Other assets | | | |
| Intangible assets | 2,169,928 | 1,980,812 | 1,831,713 |
| Less accumulated amortization of intangibles | (170,130) | (137,720) | (112,836) |
| Goodwill | 1,164,898 | 1,051,253 | 910,194 |
| Other assets | 29,769 | 26,636 | 28,672 |
| Deferred income taxes | 73,128 | 75,239 | 65,608 |
| Total other assets | 3,267,593 | 2,996,220 | 2,723,351 |
| Total assets | 5,647,388 | 5,187,973 | 4,639,337 |
| Liabilities and stockholders' equity | | | |
| Current liabilities | | | |
| Current maturities of long-term debt | 4,864 | 11,109 | 89,368 |
| Accounts payable | 58,787 | 43,815 | 42,819 |
| Income taxes payable | 79,742 | 139,638 | 102,358 |
| Accrued expenses | 309,088 | 316,548 | 295,944 |
| Current acquisition-related liabilities | 56,127 | 70,961 | 34,951 |
| Deferred income taxes | 28,919 | 26,585 | 27,820 |
| Total current liabilities | 537,527 | 608,656 | 593,260 |
| Long-term debt, net of current maturities | 3,098 | 3,127 | 17,339 |
| Long-term acquisition-related liabilities | 175,125 | 180,459 | 187,263 |
| Other long-term liabilities | 49,990 | 45,967 | 54,780 |
| Deferred income taxes | 278,591 | 263,791 | 231,240 |
| Minority interests | - | - | 848 |
| Total liabilities | 1,044,331 | 1,102,000 | 1,084,730 |
| Stockholders' equity | | | |
| Common stock CHF 0.001 par value, shares authorized - 150,000,000; shares issued - June '08 - 118,699,793; Dec. '07 - 118,699,793, June '07 - 118,699,793 | 79 | 79 | 79 |
| Additional paid-in-capital | 1,930,722 | 1,929,991 | 1,928,631 |
| Treasury stock - at cost | (21) | (33) | (33) |
| Retained earnings | 2,075,596 | 1,834,706 | 1,504,247 |
| Accumulated other comprehensive income | 596,681 | 321,230 | 121,683 |
| Total stockholders' equity | 4,603,057 | 4,085,973 | 3,554,607 |
| Total liabilities and stockholders' equity | 5,647,388 | 5,187,973 | 4,639,337 |

See Notes to Condensed Consolidated Financial Statements (Unaudited).

Synthes, Inc. and subsidiaries
Condensed Consolidated Statements of Operations (Unaudited)
For the six months ended June 30, 2008 and 2007

| | June 30, 2008 <i>in 1,000 US\$</i> | June 30, 2007 <i>in 1,000 US\$</i> |
|--|--|--|
| Net sales | 1,573,504 | 1,332,488 |
| Cost of goods sold | 263,511 | 244,483 |
| Gross profit | 1,309,993 | 1,088,005 |
| Operating expenses | | |
| Selling and promotion | 465,382 | 392,007 |
| General and administrative | 176,535 | 157,767 |
| Research and development | 83,898 | 65,764 |
| Royalty expense | 31,188 | 22,631 |
| Amortization of intangible assets | 22,144 | 18,860 |
| Operating income | 530,846 | 430,976 |
| Other income (expense) | | |
| Interest expense | (4,307) | (6,275) |
| Interest income | 7,024 | 5,104 |
| Foreign exchange (losses) gains | (15,078) | 11,904 |
| Other, net | (3,114) | (9,915) |
| Earnings before minority interest and income taxes | 515,371 | 431,794 |
| Minority interest | - | (186) |
| Earnings before income taxes | 515,371 | 431,980 |
| Income taxes | 166,572 | 149,840 |
| Net earnings | 348,799 | 282,140 |
| | | |
| Basic and diluted earnings per share (expressed in US\$) | 2.94 | 2.38 |
| | <i>in 1,000 of shares</i> | <i>in 1,000 of shares</i> |
| Weighted average number of common shares outstanding | 118,697 | 118,691 |
| Weighted average number of common shares outstanding with dilutive effect | 118,726 | 118,738 |

See Notes to Condensed Consolidated Financial Statements (Unaudited).

Synthes, Inc. and subsidiaries
Condensed Consolidated Statements of Changes in Stockholders' Equity (Unaudited)
For the six months ended June 30, 2008 and 2007

| | <u>Common stock</u> | | Additional paid-in capital <i>in 1,000 US\$</i> | Treasury stock <i>in 1,000 US\$</i> | Retained earnings <i>in 1,000 US\$</i> | Accumulated other comprehensive income (loss) <i>in 1,000 US\$</i> | Total stockholders' equity <i>in 1,000 US\$</i> | Comprehensive income (loss) <i>in 1,000 US\$</i> |
|--|-------------------------------|----------------------|--|---|--|---|--|---|
| | <i>in 1,000 of shares</i> | <i>in 1,000 US\$</i> | | | | | | |
| Balance December 31, 2006 | 118,676 | 79 | 1,924,756 | (525) | 1,327,360 | 126,980 | 3,378,650 | - |
| Adjustment to adopt FASB Interpretation No. 48, net of deferred taxes of US\$ 16.070 million | - | - | - | - | (31,816) | - | (31,816) | - |
| Net earnings YTD June 30, 2007 | - | - | - | - | 282,140 | - | 282,140 | 282,140 |
| Issuance of common stock | 24 | - | 2,494 | - | - | - | 2,494 | - |
| Re-issuance of treasury shares | - | - | 549 | 492 | - | - | 1,041 | - |
| Share-based payment arrangements compensation | - | - | 832 | - | - | - | 832 | - |
| Dividends CHF 0.7500 (US\$ 0.6187) per share | - | - | - | - | (73,437) | - | (73,437) | - |
| Foreign currency translation adjustment YTD June 30, 2007 | - | - | - | - | - | (5,297) | (5,297) | (5,297) |
| Balance June 30, 2007 | 118,700 | 79 | 1,928,631 | (33) | 1,504,247 | 121,683 | 3,554,607 | 276,843 |
| Balance December 31, 2007 | 118,700 | 79 | 1,929,991 | (33) | 1,834,706 | 321,230 | 4,085,973 | - |
| Net earnings YTD June 30, 2008 | - | - | - | - | 348,799 | - | 348,799 | 348,799 |
| Re-issuance of treasury shares | - | - | (57) | 2,890 | - | - | 2,833 | - |
| Purchase of treasury shares | - | - | - | (2,878) | - | - | (2,878) | - |
| Share-based payment arrangements compensation | - | - | 788 | - | - | - | 788 | - |
| Dividends CHF 0.9000 (US\$ 1.0102) per share | - | - | - | - | (107,909) | - | (107,909) | - |
| Foreign currency translation adjustment YTD June 30, 2008 | - | - | - | - | - | 275,451 | 275,451 | 275,451 |
| Balance June 30, 2008 | 118,700 | 79 | 1,930,722 | (21) | 2,075,596 | 596,681 | 4,603,057 | 624,250 |

See Notes to Condensed Consolidated Financial Statements (Unaudited).

Synthes, Inc. and subsidiaries
Condensed Consolidated Statements of Cash Flows (Unaudited)
For the six months ended June 30, 2008 and 2007

| | June 30, 2008 <i>in 1,000 US\$</i> | June 30, 2007 <i>in 1,000 US\$</i> |
|--|--|--|
| Cash flows from operating activities | | |
| Net earnings | 348,799 | 282,140 |
| Adjustments to reconcile net earnings to net cash provided by operating activities | | |
| Minority interest | - | (186) |
| Share-based compensation | 788 | 2,893 |
| Provisions for inventory obsolescence | 21,635 | 14,632 |
| Depreciation | 107,736 | 92,241 |
| Amortization | 22,165 | 18,879 |
| Realized foreign exchange losses (gains) | 50,077 | (8,373) |
| Changes in income taxes payable | (62,877) | (11,747) |
| Changes in working capital | (127,437) | (46,794) |
| Other | (16,766) | (8,199) |
| Net cash provided by operating activities | 344,120 | 335,486 |
| Cash flows from investing activities | | |
| Capital expenditures for property, plant and equipment | (126,497) | (102,953) |
| Consideration in connection with a prior asset acquisition | (25,138) | (81,458) |
| Contingent consideration related to prior acquisitions | (24,979) | - |
| Proceeds and payments of other instruments | (50,077) | 8,373 |
| Other investing activities | (5,729) | (9,566) |
| Net cash used in investing activities | (232,420) | (185,604) |
| Cash flows from financing activities | | |
| Principal payments of debt and capital lease obligations | (10,777) | (74,865) |
| Proceeds from issuance of long-term debt | 4,187 | 5,416 |
| Proceeds from issuance of common stock in connection with stock options | - | 433 |
| Dividends paid to stockholders | (107,909) | (73,437) |
| Purchase of treasury stock | (2,878) | - |
| Excess tax benefits from share-based arrangements | - | 186 |
| Net cash used in financing activities | (117,377) | (142,267) |
| Effects of exchange rate changes on cash and cash equivalents | 14,046 | 1,267 |
| Net increase in cash and cash equivalents | 8,369 | 8,882 |
| Cash and cash equivalents as of January 1 | 544,882 | 289,987 |
| Cash and cash equivalents as of June 30 | 553,251 | 298,869 |
| Supplemental disclosures of cash flow information | | |
| Interest paid | 547 | 4,106 |
| Income taxes paid | 237,659 | 188,193 |
| Non-cash transactions | | |
| Issuance of common stock | - | 2,061 |

See Notes to Condensed Consolidated Financial Statements (Unaudited).

1. Description and nature of operations

Synthes, Inc. and its subsidiaries (the Group) develops, manufactures, and distributes products for the operative treatment of bone fractures including both metallic and osteobiological materials. Additionally, the Group has a power tools business including development, manufacturing and distribution.

2. Basis of the condensed consolidated financial statements

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. GAAP for interim reporting and do not include all the information and notes required by U.S. GAAP for complete financial statements. In the opinion of management, the unaudited condensed consolidated financial statements include all adjustments, consisting only of normal recurring accruals, considered necessary for a fair presentation of the financial position and the results of operations. Operating results for the six-month period ended June 30, 2008 are not necessarily indicative of the results that may be expected for a full fiscal year. For further information, refer to the consolidated financial statements and notes included in the Group's Annual Report for the year ended December 31, 2007.

The consolidated financial statements include the accounts of Synthes, Inc. and all companies in which Synthes, Inc. has directly or indirectly more than a 50% voting interest. For those consolidated subsidiaries where ownership is less than 100%, the outside stockholders' interests are shown in minority interest in the accompanying financial statements. Subsidiaries are consolidated from the date of acquisition. Acquisitions of subsidiaries are accounted for using the purchase method of accounting. All intercompany transactions and balances between Group companies are eliminated.

3. Reclassifications

Certain June 2007 financial information has been reclassified to conform to the current period's presentation.

4. Segment reporting

The Group's operations are classified into four reportable segments that manufacture and sell similar products in different geographic areas. The North America, Europe, Asia Pacific and Latin America reportable segments derive their revenues from the sale of medical implants. The key determining factor in identifying the reportable segments is how the Group's Chief Executive Officer routinely reviews the Group's results.

Intersegment revenues are sales made between Group companies, and are based upon transfer prices. The "Eliminations" column consists primarily of intercompany eliminations between the reportable segments. Generally, the Group evaluates performance on the basis of revenues, operating profit and net profit.

Synthes, Inc. and subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)

4. Segment reporting (continued)

| For the six months ended June 30, 2008 | Reportable segments (in 1,000 US\$) | | | | | Consolidated totals |
|---|--|---------------|-------------------------|--------------------------|---------------------------|--------------------------------|
| | North America | Europe | Asia Pacific | Latin America | Elimi- nations | |
| External revenue | 943,543 | 416,480 | 149,938 | 63,543 | - | 1,573,504 |
| Intersegment revenue | 46,839 | 228,673 | - | - | (275,512) | - |
| Interest income | 4,889 | 1,904 | 121 | 110 | - | 7,024 |
| Interest expense | 1,001 | 3,251 | 31 | 24 | - | 4,307 |
| Depreciation and amortization | 71,257 | 59,447 | 14,422 | 4,220 | (19,445) | 129,901 |
| Segment operating income | 378,247 | 188,620 | 361 | 8,322 | (44,704) | 530,846 |
| Income tax expense (benefit) | 134,949 | 31,321 | 1,731 | 3,134 | (4,563) | 166,572 |
| Segment net earnings | 249,198 | 138,403 | (1,265) | 4,820 | (42,357) | 348,799 |
| Segment total assets | 1,626,794 | 3,549,876 | 504,035 | 162,235 | (195,552) | 5,647,388 |
| Expenditures for long-lived assets | 100,903 | 53,207 | 13,491 | 2,879 | (30,910) | 139,570 |

| For the six months ended June 30, 2007 | Reportable segments (in 1,000 US\$) | | | | | Consolidated totals |
|---|--|---------------|-------------------------|--------------------------|---------------------------|--------------------------------|
| | North America | Europe | Asia Pacific | Latin America | Elimi- nations | |
| External revenue | 842,333 | 327,400 | 114,463 | 48,292 | - | 1,332,488 |
| Intersegment revenue | 43,599 | 144,619 | - | - | (188,218) | - |
| Interest income | 3,672 | 1,203 | 161 | 68 | - | 5,104 |
| Interest expense | 2,849 | 3,356 | 39 | 31 | - | 6,275 |
| Depreciation and amortization | 61,158 | 47,333 | 11,242 | 2,962 | (11,575) | 111,120 |
| Segment operating income | 334,343 | 103,983 | 132 | 5,476 | (12,958) | 430,976 |
| Income tax expense (benefit) | 129,890 | 19,567 | 1,495 | 2,796 | (3,908) | 149,840 |
| Segment net earnings | 210,975 | 80,530 | (1,857) | 3,176 | (10,684) | 282,140 |
| Segment total assets | 1,264,045 | 2,970,730 | 424,029 | 134,206 | (153,673) | 4,639,337 |
| Expenditures for long-lived assets | 59,311 | 124,976 | 14,733 | 3,260 | (14,428) | 187,852 |

5. Earnings per share (EPS)

The following is a calculation of basic and diluted earnings per share for the six months ended June 30, 2008 and 2007. For the diluted earnings per share, the weighted average shares are adjusted to assume conversion of all potentially dilutive stock options.

| | For the six months ended June 30, 2008 <i>in 1,000 US\$</i> | For the six months ended June 30, 2007 <i>in 1,000 US\$</i> |
|--|---|---|
| Net earnings | 348,799 | 282,140 |
| | <i>in 1,000 of shares</i> | <i>in 1,000 of shares</i> |
| Weighted average number of common shares used in basic EPS | 118,697 | 118,691 |
| Effects of dilutive equity incentive plan stock options | 29 | 47 |
| Weighted average number of common shares and dilutive potential common shares used in diluted EPS | 118,726 | 118,738 |
| Basic EPS of common stock (expressed in US\$) | 2.94 | 2.38 |
| Diluted EPS of common stock (expressed in US\$) | 2.94 | 2.38 |

6. Commitments and contingencies

The Group must observe the laws, government orders and regulations of the countries in which it operates. Synthes, Inc. and certain subsidiaries are currently involved in legal and administrative proceedings arising out of the normal conduct of their business.

The Group has been named as a defendant in lawsuits alleging product failure or patent infringement. Product liability cases are routinely handled by in-house and external counsel, and management does not anticipate that any material losses will be sustained by the Group as a result of these claims.

On October 27, 2006 the Federal Court in Memphis, Tennessee issued a revised injunction order relating to the Group's TFN devices and a patent infringement case with Smith & Nephew in which the Group was named as a defendant. The order allowed the Group to continue selling its current TFN products, however, it can no longer sell or promote the use of the present TFN products to treat intertrochanteric fractures. On February 20, 2008, the Group and Smith & Nephew reached a settlement on the patent dispute. Smith & Nephew agreed to license its patents to the Group and to dissolve the injunction against the TFN devices. The effect on the Group's consolidated financial statements was not material.

On March 23, 2006, the Group received a grand jury subpoena from the United States Department of Justice United States Attorney's Office in Philadelphia. Under the subpoena, the Group was ordered to deliver certain documents and information concerning Norian XR® and related products. The Group has cooperated fully in responding to the subpoena. The document requests set forth in the subpoena suggest, among other things, that the Department of Justice is investigating the promotion, sale, and reimbursement of Norian XR® for off-label uses, i.e., outside of the scope for which it was cleared by the U.S. Food and Drug Administration (FDA). At this point in the investigation, the Group does not know when the investigation will conclude or whether a sanction will be imposed. Following an FDA inspection and a warning letter dated November 5, 2004, the Group voluntarily stopped selling Norian XR® and has had no revenues related to the product since 2004.

Based on the advice of counsel, management provides reserves for losses that are probable and reasonably estimable. Management believes the outcome of any pending litigation will not have a material adverse impact on the financial position of the Group.

7. Income taxes

The Group adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), on January 1, 2007.

The amount of gross unrecognized income tax positions, defined as the aggregate tax effect of differences between tax return positions and the benefits recognized in the Group's financial statements, at January 1, 2008 is US\$ 92.1 million. The amount of net unrecognized income tax positions, all of which would impact the Group's effective tax rate if recognized, is US\$ 78.1 million including accrued interest and penalties.

At June 30, 2008, the amount of gross unrecognized income tax positions is US\$ 39.3 million. The amount of net unrecognized income tax positions, all of which would impact the Group's effective tax rate if recognized, is US\$ 36.8 million including accrued interest and penalties. The reduction in the amount of unrecognized income tax positions resulted primarily from the settlements with taxing authorities.

8. Acquisitions

Effective December 17, 2007, the Group purchased 100% of the outstanding stock of N Spine, Inc., a privately held company based in San Diego, CA (USA) that designs, develops and markets devices to treat lumbar spinal disorders using posterior dynamic stabilization. The acquisition price included US\$ 32.4 million consisting of cash at closing and transaction costs, payments of up to US\$ 45.0 million based upon the achievement of certain milestones, and additional earn-out payments based on product sales. In connection with the milestones, the Group recorded a liability as of December 31, 2007 for the portion of the consideration considered payable beyond a reasonable doubt, and through June 30, 2008, 62% of this liability has been paid. Any additional payments of contingent consideration, beyond the remaining liability balance, are payable in cash and will be recorded as additional goodwill if and when the contingencies for such payments have been resolved.

On April 4, 2003, the Group acquired all of the outstanding stock of Spine Solutions, Inc., a marketer and developer of a total artificial disc system, called the Prodisc® system. The acquisition price was approximately US\$ 179 million in cash plus additional contingent consideration of approximately US\$ 175 million to be paid based upon certain product development milestones through 2008. Through June 30, 2008, the Group has paid approximately 94% of the additional contingent consideration.

9. Acquisition of assets

On August 28, 2006, the Group acquired the Synthes trade names and marks and substantially all of the intellectual property, including patents and patent rights from the AO Foundation ("AO"). The acquisition cost was CHF 999.9 million (US\$ 809.3 million) including a combination of stock CHF 503.4 million (US\$ 407.5 million), cash CHF 100.0 million (US\$ 80.9 million) at closing, CHF 75.0 million (US\$ 60.7 million) due six months after closing, installment payments of CHF 300.0 million (US\$ 242.8 million), and CHF 21.5 million (US\$ 17.4 million) including the assumption of certain liabilities and transaction costs net of imputed interest. As of June 30, 2008, the present value of the remaining installment payments is CHF 187.1 million (US\$ 183.8 million).

10. Financial value measurement

Effective January 1, 2008, the Group adopted the provisions of FASB Statement of Financial Accounting Standards (SFAS) No. 157 *Fair Value Measurements* (SFAS 157), for financial assets and liabilities measured on a recurring basis. SFAS 157 applies to all financial assets and financial liabilities that are being measured and reported on a fair value basis and establishes a framework for measuring fair value of assets and liabilities and expands disclosures about fair value measurements. The Group's adoption of SFAS 157 was limited to its foreign currency forward derivative contracts, and there was no impact to the condensed consolidated financial statements as a result of the adoption.

SFAS 157 includes a fair value hierarchy that is intended to increase consistency and comparability in fair value measurements and related disclosures. The fair value hierarchy is based on inputs to valuation techniques that are used to measure fair value that are either observable or unobservable. Observable inputs reflect assumptions market participants would use in pricing an asset or liability based on market data obtained from independent sources while unobservable inputs reflect a reporting entity's pricing based upon their own market assumptions. The fair value hierarchy consists of the following three levels:

10. Financial value measurement (continued)

Level 1: Inputs are quoted prices in active markets for identical assets or liabilities.

Level 2: Inputs are quoted prices for similar assets or liabilities in an active market, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable and market-corroborated inputs which are derived principally from or corroborated by observable market data.

Level 3: Inputs are derived from valuation techniques in which one or more significant inputs or value drivers are observable.

The Group utilizes the market approach to measure fair value for financial assets and liabilities. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.

The following table summarizes the valuation of the Group's financial assets and liabilities measured at fair value on a recurring basis as of June 30, 2008 and the basis for that measurement (*in 1,000 US\$*):

| | Total Fair Value Measurement June 30, 2008 | Quoted Prices In Active Markets For Identical Assets Or Liabilities (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|----------------------------|---|--|--|--|
| Assets: | | | | |
| Derivative assets (1) | \$ 5,227 | \$ - | \$ 5,227 | \$ - |
| Liabilities: | | | | |
| Derivative liabilities (2) | \$ 2,782 | \$ - | \$ 2,782 | \$ - |

(1) Contained within prepaid expenses and other current assets in the condensed consolidated balance sheet as of June 30, 2008.

(2) Contained within accrued expenses, and other long-term liabilities in the condensed consolidated balance sheet as of June 30, 2008.

11. Financial derivatives

The Group has entered into forward exchange contracts to minimize the impact of currency fluctuations on transactions and cash flows. A majority of these contracts have not been designated as hedges and changes in their fair value have been recorded in the consolidated statements of operations in "other income (expense)". As these contracts settle, the realized gain or loss attributed to changes in foreign currency is classified as an investing activity in the statements of cash flow. The Group recognized US\$ 50.1 million and US\$ 8.4 million in realized losses and realized gains during the first half of 2008 and 2007, respectively, related to changes in foreign currency on settled forward exchange contracts and intercompany debt agreements.

The impact of the foreign exchange derivatives, related to intercompany debt (mentioned above), on the Group's net earnings was minimal as realized gains and losses were offset by unrealized gains and losses. Additionally, payments related to the first half 2008 realized loss will be recouped as the loan is repaid and/or the Swiss Franc weakens. The first half 2008 losses were attributable to the strengthening of the Swiss Franc.