



Financial Review 2008

Financial Review

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Report of Independent Auditors

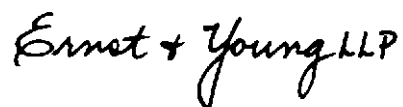
Board of Directors and Shareholders
Synthes, Inc.

We have audited the accompanying consolidated balance sheets of Synthes, Inc. and subsidiaries (the Group) as of December 31, 2008 and 2007, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Group as of December 31, 2008 and 2007, and the consolidated results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

As discussed in Notes B21 and C5 to the consolidated financial statements, the Group adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, effective January 1, 2007.

The logo for Ernst & Young LLP is written in a black, cursive script. The words "Ernst & Young" are in a larger, more prominent font, with "LLP" in a smaller font to the right. The ampersand is stylized and connects the two names.

Philadelphia, Pennsylvania
February 12, 2009

Report of Independent Accountants

Board of Directors
Synthes, Inc.

We have examined the suitability of Synthes, Inc.'s design of internal control over financial reporting to prevent or detect material misstatements in the financial statements on a timely basis as of December 31, 2008, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Synthes, Inc.'s management is responsible for the suitable design of internal control over financial reporting. Our responsibility is to express an opinion on the design of internal control based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included obtaining an understanding of internal control over financial reporting, evaluating the design of internal control, and performing such other procedures as we considered necessary in the circumstances. Our procedures included performing walkthroughs to test for the existence of internal controls. We believe that our examination provides a reasonable basis for our opinion.

We were not engaged to examine and report on the operating effectiveness of Synthes, Inc.'s internal control over financial reporting as of December 31, 2008, and, accordingly, we express no opinion on operating effectiveness.

Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of the internal control over financial reporting to future periods are subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Synthes, Inc.'s internal control over financial reporting is suitably designed, in all material respects, to prevent or detect material misstatements in the financial statements on a timely basis as of December 31, 2008, based on the COSO criteria.

Ernst + Young LLP

Philadelphia, Pennsylvania
February 12, 2009

Synthes, Inc. and Subsidiaries

Consolidated Balance Sheets as of December 31,
2008 and 2007

Assets	2008	2007
Current assets	<i>in 1,000 US\$</i>	<i>in 1,000 US\$</i>
Cash and cash equivalents	871,543	544,882
Accounts receivable		
Trade, less allowance of US\$ 20.4 million and US\$ 21.1 million in 2008 and 2007, respectively	565,884	483,227
Other	60,922	44,526
Inventories, net	471,335	439,978
Prepaid expenses and other current assets	50,531	41,688
Deferred income taxes	40,835	34,090
Total current assets	2,061,050	1,588,391
Property, plant and equipment, net	643,850	603,362
Other assets		
Intangible assets, less accumulated amortization of US\$ 188.2 million and US\$ 137.7 million in 2008 and 2007, respectively	1,919,258	1,843,092
Goodwill	1,123,716	1,051,253
Other assets	58,454	26,636
Deferred income taxes	90,930	75,239
Total other assets	3,192,358	2,996,220
Total assets	5,897,258	5,187,973

Liabilities and stockholders' equity	2008	2007
Current liabilities	<i>in 1,000 US\$</i>	<i>in 1,000 US\$</i>
Current maturities of long-term debt	2,007	11,109
Accounts payable	45,970	43,815
Income taxes payable	62,520	139,638
Accrued payroll and other compensation and benefits including withholding taxes and pensions	170,407	150,128
Accrued taxes other than income and payroll	28,663	25,672
Accrued expenses other	128,192	133,630
Current acquisition-related liabilities	96,106	78,079
Deferred income taxes	25,103	26,585
Total current liabilities	558,968	608,656
Long-term debt, net of current maturities	2,770	3,127
Long-term acquisition-related liabilities	113,279	180,459
Other long-term liabilities	110,528	45,967
Deferred income taxes	285,893	263,791
Total liabilities	1,071,438	1,102,000
Stockholders' equity		
Common stock CHF 0.001 par value; shares authorized – 150,000,000; shares issued – 2008 – 118,717,913; 2007 – 118,699,793; shares outstanding – 2008 – 118,657,763; 2007 – 118,699,229	79	79
Additional paid-in capital	1,930,002	1,929,991
Treasury stock – at cost	(6,623)	(33)
Retained earnings	2,461,762	1,834,706
Accumulated other comprehensive income	440,600	321,230
Total stockholders' equity	4,825,820	4,085,973
Total liabilities and stockholders' equity	5,897,258	5,187,973

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

Synthes, Inc. and Subsidiaries

Consolidated Statements of Operations for the Years
Ended December 31, 2008 and 2007

	2008 <i>in 1,000 US\$</i>	2007 <i>in 1,000 US\$</i>
Net sales	3,192,544	2,759,717
Cost of goods sold	553,884	524,996
Gross profit	2,638,660	2,234,721
Operating expenses		
Selling and promotion	934,306	802,285
General and administrative	349,417	294,629
Research and development	169,856	148,640
Royalty expense	61,271	46,257
Amortization of intangible assets	43,666	38,279
	1,558,516	1,330,090
Operating income	1,080,144	904,631
Other income (expenses)		
Interest expense	(7,960)	(10,866)
Interest income	12,621	14,620
Foreign exchange (losses) gains	(23,975)	13,791
Other, net	(5,941)	6,118
	(25,255)	23,663
Earnings before income taxes	1,054,889	928,294
Income taxes	319,925	315,696
Net earnings	734,964	612,598
Basic and diluted earnings per share (expressed in US\$)	6.19	5.16
	<i>in 1,000 of shares</i>	<i>in 1,000 of shares</i>
Weighted average number of common shares outstanding	118,698	118,695
Weighted average number of common shares outstanding with dilutive effect	118,723	118,733

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

Synthes, Inc. and Subsidiaries

Consolidated Statements of Changes in Stockholders' Equity
for the Years Ended December 31, 2008 and 2007

	Common stock		Additional paid-in capital	Treasury stock	Retained earnings	Accumulated other comprehensive	Total Stockholders' equity	Comprehen- sive income (loss)
	in 1,000 of shares	in 1,000 US\$				income (loss)		
Balance December 31, 2006	118,676	79	1,924,756	(525)	1,327,360	126,980	3,378,650	651,749
Net earnings 2007	–	–	–	–	612,598	–	612,598	612,598
Adjustment to adopt FASB Interpretation No. 48, net of deferred taxes of US\$ 16.070 million	–	–	–	–	(31,816)	–	(31,816)	–
Issuance of common stock	24	–	2,494	–	–	–	2,494	–
Re-issuance of treasury shares	–	–	549	492	–	–	1,041	–
Dividends CHF 0.7500 (US\$ 0.6187) per share	–	–	–	–	(73,436)	–	(73,436)	–
Share-based payment arrangements compensation	–	–	2,192	–	–	–	2,192	–
Defined benefit pension plans, net of deferred taxes of US\$ (3.452) million	–	–	–	–	–	14,455	14,455	14,455
Unrealized losses on foreign currency hedges	–	–	–	–	–	(29)	(29)	(29)
Foreign currency translation adjustment 2007	–	–	–	–	–	179,824	179,824	179,824
Balance December 31, 2007	118,700	79	1,929,991	(33)	1,834,706	321,230	4,085,973	806,848
Net earnings 2008	–	–	–	–	734,964	–	734,964	734,964
Issuance of common stock	18	–	(1,735)	–	–	–	(1,735)	–
Purchases of treasury shares	–	–	–	(9,480)	–	–	(9,480)	–
Re-issuance of treasury shares	–	–	(57)	2,890	–	–	2,833	–
Dividends CHF 0.9000 (US\$ 0.9092) per share	–	–	–	–	(107,908)	–	(107,908)	–
Share-based payment arrangements compensation	–	–	1,803	–	–	–	1,803	–
Defined benefit pension plans, net of deferred taxes of US\$ 5.244 million	–	–	–	–	–	(21,346)	(21,346)	(21,346)
Unrealized losses on foreign currency hedges	–	–	–	–	–	(1,268)	(1,268)	(1,268)
Foreign currency translation adjustment 2008	–	–	–	–	–	141,984	141,984	141,984
Balance December 31, 2008	118,718	79	1,930,002	(6,623)	2,461,762	440,600	4,825,820	854,334

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

Synthes, Inc. and Subsidiaries

Consolidated Statements of Cash Flows for the Years
Ended December 31, 2008 and 2007

	2008	2007
	<i>in 1,000 US\$</i>	<i>in 1,000 US\$</i>
Cash flows from operating activities		
Net earnings	734,964	612,598
Adjustments to reconcile net earnings to net cash provided by operating activities		
Depreciation	215,777	193,662
Amortization	43,699	38,317
Share-based compensation	4,693	4,254
Provisions for inventory obsolescence	43,786	54,512
(Recovery) provisions for doubtful accounts	(221)	7,662
Deferred income tax benefit	(7,748)	(14,629)
Losses on sale of property, plant and equipment	6,006	2,705
Realized foreign exchange losses	6,827	5,758
Other	6,454	(10,988)
Changes in assets and liabilities, net of effects of business acquisitions		
Accounts receivable trade	(100,908)	(39,625)
Accounts receivable other	(10,108)	5,611
Inventories	(77,804)	(26,552)
Prepaid expenses and other current assets	(7,107)	(5,915)
Accounts payable	16,771	(957)
Income taxes payable	(80,639)	22,776
Accrued expenses	23,659	25,182
Net cash provided by operating activities	818,101	874,371

	2008	2007
	<i>in 1,000 US\$</i>	<i>in 1,000 US\$</i>
Cash flows from investing activities		
Capital expenditures for property, plant and equipment	(261,086)	(223,061)
Consideration in connection with a prior asset acquisition	(46,163)	(104,188)
Contingent consideration related to prior acquisitions	(32,448)	(26,952)
Business acquisitions, net of cash acquired	(4,047)	(36,562)
Purchase of minority interest	–	(2,500)
Proceeds from disposal of property, plant and equipment	234	988
Payments of other instruments	(6,827)	(5,758)
Investment in nonconsolidated investments and other long-term assets	(9,432)	(1,708)
Disposals of nonconsolidated investments and other long-term assets	4,183	1,347
Issuance of loans	(4,300)	(331)
Proceeds from loans	44	6,293
Net cash used in investing activities	(359,842)	(392,432)
Cash flows from financing activities		
Principal payments of debt and capital lease obligations	(10,800)	(165,669)
Proceeds from issuance of long-term debt	1,404	–
Purchases of treasury shares	(11,215)	–
Proceeds from issuance of common stock in connection with stock options	–	433
Dividends paid to stockholders	(107,908)	(73,436)
Excess tax benefits from share-based arrangements	1,475	182
Net cash used in financing activities	(127,044)	(238,490)
Effect of exchange rate changes on cash and cash equivalents	(4,554)	11,446
Net increase in cash and cash equivalents	326,661	254,895
Cash and cash equivalents as of January 1	544,882	289,987
Cash and cash equivalents as of December 31	871,543	544,882
Supplemental disclosures of cash flow information		
Interest paid	1,081	4,025
Income taxes paid	372,499	288,786
Noncash transactions		
Accrual of contingent consideration related to business acquisition	–	32,463

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

Synthes, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements December 31, 2008 and 2007

Note A – Basis of presentation

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.

The Group is comprised of Synthes, Inc. and the companies shown in Note C19 (list of fully consolidated companies as of December 31, 2008). Synthes, Inc. is a corporation registered in Delaware, USA.

Note B – Summary of significant accounting policies

A summary of the Group's significant accounting policies that were applied in the preparation of the accompanying consolidated financial statements follows:

1 Basis of the consolidated financial statements

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP).

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 or is the primary beneficiary of a variable interest entity. For those consolidated subsidiaries where ownership is less than 100%, the outside stockholders' interests are shown in minority interest in the accompanying consolidated 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.

2 Foreign currency translation

The financial statements of the holding company's subsidiaries outside the United States of America are translated into US dollars (US\$), the Group's reporting currency, as follows:

The balance sheets are translated at year-end rates.

The statements of operations are translated at the weighted average exchange rates for the period. Weighted average exchange rates are calculated based on monthly average rates for the applicable currencies. Translation adjustments are charged or credited to accumulated other comprehensive income.

Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transaction. Gains and losses resulting from the settlement of such transactions and from the remeasurement of monetary assets and liabilities denominated in foreign currencies are recognized in the consolidated statements of operations.

The following is a summary of exchange rates used in relation to US\$:

		Year-end rates		Weighted	
		at December 31		average rates for year	
		2008	2007	2008	2007
CHF	1 =	0.9450	0.8813	0.9233	0.8335
CDN	1 =	0.8172	1.0202	0.9383	0.9338
GBP	1 =	1.4436	1.9960	1.8411	2.0007
SEK	100 =	12.8880	15.6100	15.2336	14.8096
NOK	100 =	14.2440	18.3800	17.8299	17.0975
DKK	100 =	18.893	19.7400	19.6271	18.3778
MXN	100 =	7.2588	9.1900	9.0152	9.1574
CZK	100 =	5.3150	5.5370	5.8775	4.9443
HUF	100 =	0.5292	0.5790	0.5837	0.5459
EUR	1 =	1.4081	1.4655	1.4635	1.3692
ARS	1 =	0.2894	0.3179	0.3169	0.3218
BRL	1 =	0.4288	0.5682	0.5528	0.5154
COP	100 =	0.0450	0.0500	0.0517	0.0493
PLN	100 =	34.0210	40.8630	41.8183	36.2708
AUD	1 =	0.6891	0.8758	0.8441	0.8380
CNY	1 =	0.1463	0.1371	0.1441	0.1316
HKD	1 =	0.1287	0.1282	0.1285	0.1282
IDR	100 =	0.0091	0.0110	0.0105	0.0110
INR	1 =	0.0208	0.0254	0.0230	0.0242
JPY	100 =	1.1069	0.8830	.9731	0.8493
KRW	100 =	0.0793	0.1070	0.0922	0.1084
MYR	1 =	0.2873	0.3013	0.3002	0.2919
NZD	1 =	0.5752	0.7722	0.7079	0.7359
RUB	100 =	3.4023	4.0770	4.0247	3.9105
SGD	1 =	0.6941	0.6909	0.7059	0.6637
THB	100 =	2.8738	3.3620	3.0500	3.1246
TWD	100 =	3.0282	3.0780	3.1670	3.0438
ZAR	1 =	0.1065	0.1462	0.1222	0.1422
PEN	1 =	0.3182	0.3379	0.3463	0.3268
CRC	100 =	0.1796	0.2050	0.1933	0.1988

3 Reclassifications

Certain 2007 financial information has been reclassified to conform to the current-year presentation.

4 Cash and cash equivalents

Cash and cash equivalents consist of cash and highly liquid short-term investments with original maturities of three months or less. The Group places its cash and cash equivalents in financial institutions that are highly rated. Management believes it effectively safeguards cash assets given the current economic conditions.

5 Accounts receivable

The majority of the Group's accounts receivable are due from various health care facilities. Credit is extended based on evaluation of a customer's financial condition and, generally, collateral is not required. Accounts receivable are stated at amounts due from customers net of an allowance for doubtful accounts. Payment terms vary. Accounts outstanding longer than the payment terms are considered past due. The Group determines its allowance for doubtful accounts by considering a number of factors, including the length of time trade accounts receivable are past due, previous loss history, the customer's current ability to pay its obligation, and the condition of the general economy and industry as a whole. The Group writes off accounts receivable when they are determined to be uncollectible.

6 Inventories

Inventories are stated at the lower of cost or market, using the first-in, first-out method. The Group maintains provisions for excess and obsolete inventory. The Group estimates these provisions based on historical experience and expected future trends.

7 Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on the straight-line method over the estimated useful life of the asset. The estimated useful lives are as follows:

Land	–
Buildings	30–50 years
Building improvements	10–20 years
Machinery and fixtures	3–12 years
Equipment/EDP	3–8 years
Loan sets and samples	3 years
Vehicles	3–8 years

8 Impairment of long-lived assets

The Group follows Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, to evaluate impairment of intangible assets subject to amortization and other long-lived assets, other than goodwill and indefinite-lived intangible assets. The Group periodically evaluates whether current facts or circumstances indicate that the carrying value of such assets to be held and used may not be recoverable. If such circumstances are determined to exist, an estimate of undiscounted future cash flows to be produced by the long-lived asset is compared to the carrying value to determine wheth-

er impairment exists. If an asset is determined to be impaired, the loss is measured based on fair value using quoted market prices in active markets, if available. If quoted market prices are not available, the estimate of fair value is based on various valuation techniques, including discounted estimated future cash flows.

9 Intangible assets

Intangible assets with finite lives consist mainly of customer relationships, acquired patents and patent rights, software, product-related know-how, and licensing and marketing agreements and are amortized on a straight-line basis over their estimated useful lives, ranging from 5 to 40 years. Such assets are evaluated for impairment in accordance with SFAS No. 144 as described in Note B8.

Intangible assets with indefinite lives consist of the Synthes trade names and geographic marketing rights. Indefinite-lived assets are not amortized but are required to be tested for potential impairment at least annually, or whenever impairment indicators exist. Such assets are deemed to be impaired if book value exceeds estimated fair value.

10 Goodwill

The excess of cost over fair value of assets acquired in business combinations (goodwill) is assigned to specific reporting units and is tested for possible impairment at least annually, or whenever impairment indicators exist. Potential impairment is indicated when the carrying value of a reporting unit, including goodwill, exceeds its fair value. If potential for impairment exists, an impairment charge is recognized when the carrying value of a reporting unit's goodwill exceeds its implied fair value. Goodwill is allocated among the Group's four reportable segments that manufacture and sell similar products in different geographic areas.

11 Other assets

Other long-term assets are primarily nonconsolidated investments, loans and other deferred costs. Nonconsolidated investments are stated at cost, less any impairment adjustments. Loans are long-term loans to third parties which are carried at cost.

12 Contingencies

Synthes records provisions for contingencies when it is judged probable that a liability has been incurred and the amount can be reasonably estimated. These provisions are adjusted periodically as assessments change or additional information becomes available.

Product liabilities

Product liability cases are routinely handled by in-house counsel and external counsel. Provisions are made for present product liability obligations resulting from past sales including related legal and other fees and expenses. The provision is actuarially determined taking into consideration such factors as past experience, amount and number of claims reported and estimates of claims incurred but not yet reported. Individually significant cases are provided for when probable and reasonably estimable. Management does not anticipate that any material losses not covered by the provision will be sustained by the Group as a result of these claims.

Legal liabilities

Provisions are made for anticipated settlement or judgment costs where a reasonable estimate can be made of the probable outcome of legal proceedings or claims against the Group.

13 Revenue recognition

Sales are recognized on products when the related goods have been shipped, title has passed to the customer, and there are no undelivered elements or uncertainties. For consignment inventory, revenue is recognized when the Group is notified that the product has been used.

Services revenue, which is insignificant, is recognized upon the completion of refurbishment of certain products and the shipment of that product back to the customer.

Amounts billed to customers for shipping and handling of products are included in net sales. Costs incurred related to shipping and handling are included in cost of sales.

The Group records estimated sales returns and allowances as a reduction of net sales in the same period revenue is recognized.

14 Income taxes

The Group follows Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes*. Under the liability method specified by SFAS No. 109, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities as measured by the enacted tax rates that will be in effect when these differences are expected to reverse. Deferred income tax expense (benefit) is the result of changes in deferred tax assets and liabilities during the year. The Group recognizes interest and penalties related to unrecognized income tax positions in income tax expense. On January 1, 2007, the Group adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, as described in Notes B21 and C5.

15 Equity compensation

The Group has an equity incentive plan for directors and employees, which is a fixed employee stock-based compensation plan. Under this plan, the Group may grant options and shares for up to 1,500,000 shares of Common Stock. The exercise price of each option is equal to the market price of the Group's stock on the date of grant. The maximum term of the options ranges from 8 to 14 years and the options vest over periods ranging from immediately to 5 years. Certain option and share awards provide for accelerated vesting if there is a change of control (as defined by the plan).

The Group accounts for those plans under the fair value recognition provisions of FASB Statement No. 123(R), *Share-Based Payment*. Compensation cost includes compensation cost for all share-based payments based on the grant-date fair value estimated in accordance with the provisions of Statement 123(R).

16 Financial instruments

In assessing the fair value of financial instruments, the Group uses a variety of methods and makes assumptions that are based on market conditions existing at each balance sheet date. The fair values of investments are based on quoted market prices at the balance sheet date. Other techniques, such as estimated discounted val-

ue of future cash flows, are used to determine fair value for the remaining financial instruments. The carrying value of financial instruments approximates fair value.

17 Concentrations of credit risk

Financial instruments that may potentially subject the Group to concentration of credit risk consist principally of cash, cash equivalents, trade accounts receivable and derivatives. All cash, cash equivalents, and derivatives are placed in financial institutions with strong credit ratings, which minimizes the risk of loss due to nonpayment.

Concentration of credit risks with respect to trade accounts receivable is limited, due to the large number of customers and their dispersion across many geographic areas. Also, the Group has policies in place to ensure that sales of products and services are made to customers with an appropriate credit history. However, a significant portion of trade accounts receivable is with national health care systems in several countries. Although the Group does not currently foresee a credit risk associated with these receivables, repayment is dependent upon the financial stability of those customers.

18 Derivatives

The Group uses derivative financial instruments to manage interest rate risk and currency exchange risk. While these derivative financial instruments are subject to fluctuations in value, these fluctuations are generally offset by the value of the underlying exposures. The Group minimizes the risk of credit loss by entering into these agreements with major financial institutions that have high credit ratings. The Group accounts for its derivative financial instruments in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, referred to as SFAS 133, as amended by SFAS 138 and SFAS 149, which requires companies to recognize all of their derivative instruments as either assets or liabilities in the balance sheet at fair value.

The Group is exposed to foreign currency fluctuations relating to its operations throughout the world. The Group periodically enters into forward exchange contracts in order to minimize the impact of currency fluctuations on transactions and cash flows. A portion of these contracts are designated as cash flow hedges and are recorded at their fair value on the accompanying consolidated balance sheets in other current assets and accrued liabilities, while the related gains and losses are deferred in other comprehensive income in the equity section of the consolidated balance sheets. Amounts so deferred on these cash flow hedges are recognized when product is ultimately sold to third-party customers. All derivatives designated as cash flow hedges in 2008 and 2007 had maturities of less than 6 months at inception. The remainder of these contracts have not been designated as hedges and are also valued and recorded at their fair value on the accompanying consolidated balance sheets in other current assets and accrued liabilities. Changes in the fair value of these undesignated derivative contracts are recorded currently in the consolidated statements of operations in "foreign exchange (losses) gains" (Note C22).

The Group does not have any interest rate derivatives outstanding as of December 31, 2008, or 2007.

19 Advertising costs

Advertising and promotion costs are expensed as incurred, and were US\$ 38.0 million and US\$ 40.7 million in 2008 and 2007, respectively.

20 Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses. Actual results could differ from these estimates. Significant areas that require management's estimates include the allowance for doubtful accounts receivable, provision for obsolete inventories, fair values of acquired assets and liabilities, useful lives of assets, product liability claims, commitments and contingencies, and income taxes. The Group is subject to risks and uncertainties, such as changes in the health care environment, regulatory oversight, changes in the financial markets, competition and legislation that may cause actual results to differ from estimated results.

21 New accounting standards

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), an interpretation of SFAS 109, *Accounting for Income Taxes*, to create a single model to address accounting for uncertainty in tax positions. FIN 48 clarifies the accounting for income taxes, by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. On January 1, 2007, the Group adopted the provisions of FIN 48 as required. The effect of adopting FIN 48 was to reduce retained earnings by US\$ 31.8 million, net of deferred income taxes.

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. SFAS 157 applies under other accounting pronouncements that require or permit fair value measurements, but does not require any new fair value measurements. SFAS 157 is effective for fiscal years beginning on or after November 15, 2007, and interim periods within those fiscal years. As disclosed in Note C22, effective January 1, 2008, the Group adopted the provisions of SFAS 157 related to financial assets and financial liabilities, and there was no impact to the consolidated financial statements as a result of the adoption. In accordance with FASB Staff Position (FSP) No. 157-2, *Effective Date of FASB Statement No. 157* (FSP 157-2), the Group will defer the adoption of SFAS 157 for its nonfinancial assets and nonfinancial liabilities, except those items recognized or disclosed at fair value on an annual or more frequently recurring basis, until January 1, 2009.

In October 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, an amendment of FASB Statements No. 87, 88, 106 and 132(R) (SFAS 158). This statement requires plan sponsors of defined benefit pension and other postretirement benefit plans (collectively, "post-retirement benefit plans") to recognize, on their balance sheets, an asset or liability reflecting the funded status of their postretirement benefit plans as the difference between the projected benefit obligation and fair value of plan assets with changes continuing to be reflected in the accumulated other comprehensive income

(loss) component of stockholders' equity, net of related income taxes. This statement also requires an entity to measure the fair value of plan assets and benefit obligations as of the date of the fiscal year-end statement of financial position, and provide additional disclosures. This statement did not change the calculation of the amount of net periodic benefit cost included in net earnings. As of December 31, 2007, the Group fully adopted the recognition and disclosure provisions of SFAS 158.

In February 2007, the FASB released SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). SFAS 159 permits entities to choose to measure certain financial instruments and other items at fair value. If the Group elects the fair value option, it would be required to recognize changes in fair value in its earnings. This standard also includes presentation and disclosure requirements designed to improve comparability between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS 159 is effective at the beginning of the first fiscal year beginning after November 15, 2007. Effective January 1, 2008, the Group adopted SFAS 159, as required, and elected not to apply the fair value option to any of its financial instruments or other items.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* (SFAS 141(R)) and SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51* (SFAS 160). SFAS 141(R) establishes new principles and requirements for accounting for business combinations, including recognition and measurement of identifiable assets acquired, goodwill acquired, liabilities assumed, and noncontrolling financial interests. SFAS 160 requires all entities to report noncontrolling (minority) interests in subsidiaries as equity in the consolidated financial statements. These new standards will significantly change the accounting for and reporting of business combination transactions and noncontrolling (minority) interests in consolidated financial statements. SFAS 141(R) and SFAS 160 are required to be adopted simultaneously and are effective for fiscal years beginning on or after December 15, 2008. Earlier adoption is prohibited. SFAS 141(R) is expected to impact how the Group will identify, negotiate, and value future acquisitions and, depending on the magnitude, could have a material impact on how an acquisition will affect the Group's consolidated financial statements. SFAS 160 is not expected to have a material effect on the Group's consolidated financial statements as the Group currently does not have a minority interest in a subsidiary.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* (SFAS 161), which will require increased disclosures about an entity's strategies and objectives for using derivative instruments; the location and amounts of derivative instruments in an entity's financial statements; how derivative instruments and related hedged items are accounted for under SFAS No. 133, *Accounting for Derivative and Hedging Activities* (SFAS 133); and how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. Certain disclosures will also be required with respect to derivative features that are credit-risk related. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. SFAS 161 encourages, but does not require, comparative disclosures for earlier periods at initial adoption. The Group does not expect the adoption of this standard to have a material effect on the Group's consolidated financial statements.

Synthes, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements
December 31, 2008 and 2007

Note C – Footnotes

1 Accounts receivable other

Following is a summary of accounts receivable other at December 31:

	2008 <i>in 1,000 US\$</i>	2007 <i>in 1,000 US\$</i>
Refundable taxes, principally value added tax (V.A.T.)	44,924	28,334
Deposits	2,944	2,187
Due from officers, directors and employees	3,280	3,478
All other	9,774	10,527
	60,922	44,526

2 Inventories

Inventories are summarized at December 31, as follows:

	2008 <i>in 1,000 US\$</i>	2007 <i>in 1,000 US\$</i>
Raw materials	62,890	74,345
Work-in-progress and semi-finished products	110,451	95,740
Finished products	346,699	303,981
Customer consignment stock	66,827	51,663
Gross value	586,867	525,729
Less provision for obsolescence	(115,532)	(85,751)
Net value	471,335	439,978

3 Property, plant and equipment

Details of property, plant and equipment at December 31, are as follows:

	2008 <i>in 1,000 US\$</i>	2007 <i>in 1,000 US\$</i>
Land and buildings	252,349	236,474
Machines and fixtures	394,634	360,710
Office equipment, field equipment and vehicles	961,015	823,053
	1,607,998	1,420,237
Less: accumulated depreciation	(1,010,193)	(839,560)
	597,805	580,677
Construction in progress	46,045	22,685
	643,850	603,362

Depreciation expense recorded in the consolidated statements of operations was US\$ 215.8 million and US\$ 193.7 million in 2008 and 2007, respectively.

4 Intangible assets

Following is a summary of intangible assets, excluding goodwill, at the end of the year:

	December 31, 2008		
	Total <i>in 1,000 US\$</i>	Gross amount <i>in 1,000 US\$</i>	Accumulated amortization <i>in 1,000 US\$</i>
Finite lived:			
Product intangible assets	72,193	105,400	(33,207)
Customer relationships	721,117	824,841	(103,724)
Patents/Patent rights	182,073	212,812	(30,739)
Other intangible assets	17,143	37,662	(20,519)
Subtotal – finite-lived intangible assets	992,526	1,180,715	(188,189)
Indefinite lived:			
Geographic marketing rights	236,258	236,258	–
Trade names	690,474	690,474	–
Subtotal – indefinite-lived intangible assets	926,732	926,732	–
Total – intangible assets	1,919,258	2,107,447	(188,189)

	December 31, 2007		
	Total <i>in 1,000 US\$</i>	Gross amount <i>in 1,000 US\$</i>	Accumulated amortization <i>in 1,000 US\$</i>
Finite lived:			
Product intangible assets	80,067	105,400	(25,333)
Customer relationships	691,655	769,396	(77,741)
Patents/Patent rights	187,170	204,082	(16,912)
Other intangible assets	8,830	26,564	(17,734)
Subtotal – finite-lived intangible assets	967,722	1,105,442	(137,720)
Indefinite lived:			
Geographic marketing rights	220,325	220,325	–
Trade names	655,045	655,045	–
Subtotal – indefinite-lived intangible assets	875,370	875,370	–
Total – intangible assets	1,843,092	1,980,812	(137,720)

The increases in gross amount of trade names, customer relationships and geographic marketing rights from December 31, 2007 to December 31, 2008 result from changes in foreign currency translation rates.

Amortization expense for intangible assets, was US\$ 43.7 million and US\$ 38.3 million in 2008 and 2007, respectively. Estimated amortization expense for each of the five years through December 31, 2013 is as follows (in millions): US\$ 44.1, US\$ 44.0, US\$ 43.5, US\$ 43.3 and US\$ 43.1, respectively.

5 Income taxes

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

Deferred tax assets and liabilities recognized in the consolidated balance sheets as of December 31, are as follows:

	2008	2007
	<i>in 1,000 US\$</i>	<i>in 1,000 US\$</i>
Deferred income tax assets		
Product liability	7,439	6,298
Net operating loss carryforwards	15,144	21,893
Inventories	54,146	47,937
Accounts receivable	12,858	11,920
Payments to employees	8,819	8,626
Other	46,551	34,378
Gross deferred income tax assets	144,957	131,052
Valuation allowance	(11,932)	(21,722)
Net deferred income tax assets	133,025	109,330
Deferred income tax liabilities		
Accelerated tax depreciation	(32,862)	(20,279)
Intangible assets	(244,591)	(225,416)
Inventories	(11,245)	(19,271)
Other	(23,558)	(25,411)
Gross deferred income tax liabilities	(312,256)	(290,377)
Net deferred income tax liabilities	(179,231)	(181,047)

At December 31, 2008, the approximate amounts and expiration of net operating loss carryforwards (primarily foreign) are as follows (in millions): 2009: US\$ 0.1, 2010–2013: US\$ 4.0, 2014 and later years: US\$ 17.0, and US\$ 21.8 have an indefinite carryforward period.

The change in net deferred income tax liabilities is as follows:

	2008	2007
	<i>in 1,000 US\$</i>	<i>in 1,000 US\$</i>
Beginning of the year	(181,047)	(174,608)
Statement of operations benefit	7,748	14,629
N Spine purchase accounting	–	(5,378)
Pension liability adjustment	5,326	(83)
Currency translation adjustment	(11,258)	(15,607)
End of the year	(179,231)	(181,047)

Deferred income tax assets and liabilities are included in the consolidated balance sheets as follows:

	2008	2007
	<i>in 1,000 US\$</i>	<i>in 1,000 US\$</i>
Current assets – deferred income taxes	40,835	34,090
Noncurrent assets – deferred income taxes	90,930	75,239
Current liabilities – deferred income taxes	(25,103)	(26,585)
Noncurrent liabilities – deferred income taxes	(285,893)	(263,791)
Total net deferred tax liabilities	(179,231)	(181,047)

Cumulative undistributed earnings of foreign subsidiaries, for which no U.S. income or foreign withholding taxes have been recorded, approximated US\$ 593 million at December 31, 2008. As the Group intends to permanently reinvest all such earnings, no provision has been made for income taxes that may become payable upon distribution of such earnings, and it is not practicable to determine the amount of the related unrecognized deferred income tax liability. While there are no specific plans to distribute the undistributed earnings in the immediate future, where economically appropriate to do so, such earnings may be remitted.

Tax expense consists of:

	2008	2007
	<i>in 1,000 US\$</i>	<i>in 1,000 US\$</i>
Current taxes	327,673	330,325
Deferred tax benefit	(7,748)	(14,629)
	319,925	315,696

The following reconciles the provision for income taxes, at the U.S. statutory federal income tax rate to the provision for income taxes as reported:

	2008	2007
	<i>in 1,000 US\$</i>	<i>in 1,000 US\$</i>
Earnings before income taxes	1,054,889	928,294
Tax expense calculated at a statutory tax rate of 35%	369,211	324,903
Effect of permanent items	(18,369)	(2,550)
Effect of taxes in other countries	(56,532)	(32,064)
State income taxes, net of federal income tax benefit	29,626	19,277
Tax benefits relating to tax credits	(5,158)	(16,046)
Increase in unrecognized tax positions, net	1,147	22,176
Income tax expense	319,925	315,696

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. FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance for the measurement and classification of tax positions, interest and penalties, and requires additional disclosure on an annual basis.

Upon adoption, the Group recognized a US\$ 31.8 million net liability increase for unrecognized income tax positions, including a US\$ 3.1 million increase for accrued interest and penalties. This net liability increase resulted in a corresponding decrease to the January 1, 2007 retained earnings balance, and increases to prepaid expenses and other current assets, other assets, income taxes payable and other long-term liabilities of (in millions US\$) 24.8, 5.5, 47.4 and 14.7, respectively.

The amount of gross unrecognized income tax benefits at December 31, 2007 is US\$ 92.1 million, and the amount of accrued interest and penalties related to unresolved income tax positions is US\$ 18.8 million, net of tax. The amount of net unrecognized income tax benefits at January 1, 2008, all of which would, if recognized, impact the Group's effective tax rate, is US\$ 78.1 million including accrued interest and penalties. At December 31, 2008, the amount of gross unrecognized income tax benefits is US\$ 64.0 million. The amount of net unrecognized income tax benefits, all of which would, if recognized, impact the Group's effective tax rate is US\$ 45.4 million including accrued interest and penalties. In 2008, the reduction in expense for interest and penalties related to unresolved income tax positions amounted to US\$ (3.0) million, net of tax. At December 31, 2008, accrued interest and penalties related to unresolved income tax positions were US\$ 15.8 million, net of tax.

The Group operates in various tax jurisdictions both inside and outside the United States. At December 31, 2008, tax authorities in several tax jurisdictions were conducting routine audits of the Group's income tax returns filed in prior years. With a few exceptions, the Group is no longer subject to audits by tax authorities for tax years prior to 2005. Tax years subsequent to 2004 are open to examination in many of the tax jurisdictions in which the Group operates.

Following is a reconciliation of beginning and ending amounts of gross unrecognized income tax positions for fiscal years 2008 and 2007:

	2008	2007
	<i>in 1,000 US\$</i>	<i>in 1,000 US\$</i>
Beginning Balance January 1st	92,056	86,372
Increase from current-year tax positions	15,444	3,936
Increase from prior years' tax positions	18,519	13,145
Decrease from prior years' tax positions	(18,380)	(7,309)
Decrease from settlements with taxing authorities	(43,248)	(4,088)
Decrease from lapse of statute of limitations	(355)	–
Ending Balance December 31st	64,036	92,056

It is expected that the amount of tax liability for unrecognized income tax positions will change in the next twelve months; however, these changes are not expected to have a significant impact on the Group's consolidated statements of operations or financial position.

6 Goodwill

Changes in the carrying amount of goodwill during 2008 and 2007, by reporting unit and in the aggregate, are summarized in the following tables:

2008	Total <i>in 1,000 US\$</i>	North America <i>in 1,000 US\$</i>	Europe <i>in 1,000 US\$</i>	Asia Pacific <i>in 1,000 US\$</i>	Latin America <i>in 1,000 US\$</i>
Balance, January 1, 2008	1,051,253	78,752	857,198	70,525	44,778
Arising from contingent consideration for previously completed business combination	4,548	2,890	1,492	–	166
Currency translation adjustments	67,915	–	59,804	4,794	3,317
Balance, December 31, 2008	1,123,716	81,642	918,494	75,319	48,261

2007	Total <i>in 1,000 US\$</i>	North America <i>in 1,000 US\$</i>	Europe <i>in 1,000 US\$</i>	Asia Pacific <i>in 1,000 US\$</i>	Latin America <i>in 1,000 US\$</i>
Balance, January 1, 2007	911,633	27,702	777,116	65,404	41,411
Arising in completed business combinations	42,760	40,266	2,389	–	105
Arising from contingent consideration for previously completed business combination	26,952	10,784	16,168	–	–
Currency translation adjustments	69,908	–	61,525	5,121	3,262
Balance, December 31, 2007	1,051,253	78,752	857,198	70,525	44,778

7 Long-term debt

Details of long-term debt as of December 31, are as follows:

	2008 <i>in 1,000 US\$</i>	2007 <i>in 1,000 US\$</i>
Unsecured loans	1,663	10,767
Other, including capital lease obligations	3,114	3,469
	4,777	14,236
Less: current maturities	(2,007)	(11,109)
	2,770	3,127

Required principal payments for the next five years and thereafter are as follows:

Year ended December 31	<i>in 1,000 US\$</i>
2009	2,007
2010	280
2011	133
2012	136
2013	152
Thereafter	2,069

Details of significant debt agreements at December 31, 2008 are as follows:

Debt consists of other debt and capital leases.

The Guaranteed Senior Notes have principal balances at December 31, 2008 and 2007 of US\$ 0.0 million and US\$ 10.7 million, respectively. The Guaranteed Senior Notes were repaid in 2008.

8 Leases

Leased assets included in property, plant and equipment, where the Group is a lessee under a capital lease, are comprised of a single building, office equipment and vehicles as of December 31, 2008 and 2007. Following is a summary of property held under capital leases as of December 31:

	2008	2007
	<i>in 1,000 US\$</i>	<i>in 1,000 US\$</i>
Cost	6,076	6,034
Accumulated depreciation	(3,772)	(3,362)
Net book amount	2,304	2,672

The Group leases office buildings from a related party. One of the leases is classified as a capital lease with the related asset and liability recorded. The lease provides for minimum annual lease payments, in the aggregate, of US\$ 5.2 million through 2021, plus contingent annual rentals based on the change in the U.S. Consumer Price Index.

Minimum future lease payments under capital leases as of December 31, 2008 for each of the next five years and in the aggregate are:

Year ended December 31	Amount <i>in 1,000 US\$</i>
2009	646
2010	573
2011	411
2012	399
2013	399
Thereafter	3,158
Total minimum lease payments	5,586
Less: amount representing interest	(2,472)
Present value of minimum lease payments	3,114

Operating leases consist primarily of rental agreements for real estate, aircraft, machinery and office equipment expiring in various years through 2021, generally with options to renew.

Payments made under operating leases are charged to the consolidated statement of operations on a straight-line basis over the period of the lease.

The future minimum rental payments as of December 31, 2008 under noncancelable operating leases having initial or remaining terms in excess of one year are:

Year ended December 31	Amount <i>in 1,000 US\$</i>
2009	10,190
2010	7,885
2011	3,882
2012	1,628
2013	825
Thereafter	1,307
Total minimum future rental payments	25,717

Operating lease expense for the years ended December 31, 2008 and 2007 was US\$ 15.5 million and US\$ 14.3 million, respectively.

9 Pensions and other postretirement benefits

Upon retirement, employees of certain non-U.S. subsidiaries are entitled to pensions according to the laws and practices of the individual countries where the employees are located.

Certain non-U.S. subsidiaries have defined benefit pension plans. The major defined benefit pension plans provide pensions as well as life and disability insurance mainly for subsidiaries in Switzerland.

Following are reconciliations of the pension benefit obligation and plan assets for 2008 and 2007:

	2008 <i>in 1,000 US\$</i>	2007 <i>in 1,000 US\$</i>
Pension benefit obligation		
Balance, beginning of year	(244,299)	(228,166)
Service cost	(23,029)	(20,939)
Past service cost	–	(659)
Interest cost	(8,765)	(6,608)
Curtailments/settlements	–	504
Benefits paid	14,530	8,598
New plan participants	–	(4,862)
Actuarial gains	4,729	27,267
Changes in foreign currency exchange rates	(17,749)	(19,434)
Balance, end of year	(274,583)	(244,299)
Plan assets		
Fair value, beginning of year	241,656	205,932
Actual (loss) return on plan assets	(19,537)	120
Company contributions	15,399	13,412
Contributions by plan participants	10,677	9,157
Changes in foreign currency exchange rates	16,933	17,751
Benefits paid to plan participants	(14,530)	(8,598)
Contributions from new plan participants	–	3,882
Fair value, end of year	250,598	241,656
Funded status	(23,985)	(2,643)

For 2008 and 2007, the amounts recognized in the consolidated balance sheets were classified as follows:

	2008 <i>in 1,000 US\$</i>	2007 <i>in 1,000 US\$</i>
Accrued liability – noncurrent	(23,985)	(2,643)
Accumulated other comprehensive income	28,853	7,507

The underfunded status of the plans of US\$ 23.985 million and US\$ 2.643 million at December 31, 2008 and 2007, respectively, is recognized in the accompanying consolidated balance sheets in other long-term liabilities. No plan assets are expected to be returned to the Group during the fiscal year ending December 31, 2009.

The accumulated benefit obligation was US\$ 261.2 million and US\$ 232.3 million at December 31, 2008 and 2007, respectively. The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for plans with accumulated and projected benefit obligations in excess of plan assets were US\$ 273.0 million, US\$ 260.3 million and US\$ 249.4 million, respectively, as of December 31, 2008. The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for plans with projected benefit obligations in excess of plan assets were US\$ 244.3 million, US\$ 232.3 million and US\$ 241.7 million, respectively, as of December 31, 2007.

The amounts recognized in the consolidated statements of operations, for the years ended December 31, are as follows:

	2008 <i>in 1,000 US\$</i>	2007 <i>in 1,000 US\$</i>
Service cost	23,029	20,939
Interest cost	8,765	6,608
Expected return on plan assets	(10,574)	(7,984)
Net actuarial losses recognized during the year	31	450
Employee contributions	(10,677)	(9,157)
Other	–	560
Total pension expense, included in personnel costs	10,574	11,416

The pension plan assets include bonds, stock, real estate and cash with a total fair value of US\$ 250.6 million at December 31, 2008. The Swiss pension fund complies with the provisions of the Swiss Pension Fund Act (BVG; Bundesgesetz über die berufliche Vorsorge).

The last actuarial valuation was completed December 31, 2008.

Principal actuarial assumptions (expressed as weighted averages):

	2008 <i>in %</i>	2007 <i>in %</i>
Discount rate	3.50	3.50
Expected return on plan assets	3.85	4.25
Future salary increases	2.00	2.00
Future pension increases	0.25	0.50

The expected return on plan assets is based on projected long-term returns for the various asset classes in which the assets are invested, weighted by the target asset allocations. The pension plan asset allocation at December 31, 2008 and 2007 and the target allocation for 2009 are as follows:

Asset category	Target allocation	Percentage of plan assets at December 31	
	2009 <i>in %</i>	2008 <i>in %</i>	2007 <i>in %</i>
Equity securities	25.0	22.4	24.4
Debt securities	60.0	54.9	52.9
Real estate	12.0	11.2	11.2
Other	3.0	11.5	11.5
Total	100.0	100.0	100.0

The maturities of debt securities at December 31, 2008, range from 1 to approximately 12 years with a weighted-average maturity of 4.5 years. The maturities of debt securities at December 31, 2007, range from 1 to approximately 12 years with a weighted-average maturity of 4.8 years.

Pension contributions	<i>in 1,000 US\$</i>
2009 (expected)	15,325

Of the US\$ 15.3 million in cash expected to be contributed to the defined benefit pension plans during 2009, US\$ 15.3 million is estimated to be needed to satisfy minimum funding requirements, and no additional contribution is expected to be contributed at the Group's discretion.

At December 31, 2008, the following benefit payments, which reflect expected future service, are expected to be paid from the defined benefit pension plans:

Year ending December 31	<i>in 1,000 US\$</i>
2009	6,714
2010	6,160
2011	7,084
2012	7,054
2013	8,720
2014-2018	62,977

Synthes defined contribution plans

The Group has defined contribution retirement plans, which cover substantially all North American employees. The expense recorded in the consolidated statements of operations for the years ended December 31, 2008 and 2007 was US\$ 19.6 million and US\$ 28.2 million, respectively.

10 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 is, and will likely continue to be, subject to various lawsuits and claims that arise from time to time in the ordinary course of business, including those involving product liability, intellectual property, commercial, employment, real estate, environmental and antitrust matters. Legal proceedings of this nature are inherently unpredictable and substantial losses sometimes result. As a consequence, the Group may in the future incur judgments or enter into settlements of claims that could have a material adverse effect on its financial position, results of operations or cash flows. Management does not anticipate that any currently pending legal proceedings of this nature will result in any material losses not covered by provisions therefor.

Governments and regulatory authorities have been stepping up their compliance and law enforcement activities in recent years in key areas, including food and drug regulation, sales and marketing practices, corruption, environmental and antitrust matters. The Group's businesses have been subject, from time to time, to such governmental investigations and information requests and audits by regulatory authorities. Government investigations are inherently unpredictable and substantial losses sometimes result.

As previously disclosed, on March 23, 2006, the Group received a grand jury subpoena from the United States Attorney's Office for the Eastern District of Pennsylvania. Additional, related subpoenas have been received since that time. Under the subpoenas, the Group has been ordered to deliver certain documents and information concerning Norian XR[®], a product that the Group voluntarily stopped selling in 2004. The Group's understanding is that the focus of this investigation is the alleged promotion and sale of Norian XR[®] for off-label uses from 2002 to 2004. In January 2009, the United States Attorney's Office advised the Group that Synthes, Inc. is a target of this investigation. The Group has cooperated and continues to cooperate fully with the government in connection with this investigation. At this point, the Group cannot predict the outcome of this matter or reasonably estimate the amount or range of amounts of any fines, penalties or other payments that might be payable as a result of this matter.

The book value of pledged assets, which includes property, plant, equipment and receivables, at December 31, 2008 and 2007 was zero.

Capital expenditures for property, plant and equipment contracted for but not recognized in the consolidated financial statements are US\$ 3.1 million and US\$ 2.0 million at December 31, 2008 and 2007, respectively.

11 Share capital

Synthes, Inc. has 150,000,000 shares of Common Stock authorized with a par value of CHF 0.001 and a stated value of CHF 0.50. At December 31, 2008 and 2007, 118,717,913 shares and 118,699,793 shares were issued and fully paid, respectively.

Additionally, 150,000 shares of Series A junior participating Preferred Stock with a par value of CHF 0.01 and a stated value of CHF 5.00 have been authorized. None have been issued.

Preferred Stock is authorized only for issuance upon exercise of rights issued pursuant to the Synthes Shareholders' Rights plan. The rights under the plan become exercisable in certain circumstances where a person or persons acquires or agrees to acquire beneficial ownership of 33 1/3% or more of the Group's Common Stock. The rights provide shareholders (except the person or persons that acquired greater than 33 1/3%) the right to buy a fractional share of Preferred Stock that approximates the value of a share of Common Stock for half-price, thereby substantially diluting the value of the Group's existing Common Stock.

The holders of Synthes, Inc. Common Stock are entitled to receive dividends as declared from time to time and are entitled to one vote per share at the General Meeting of Shareholders. The stock is listed on the Swiss Stock Exchange (SIX Swiss Exchange).

Equity incentive plan

Under the equity incentive plan, each Common Stock option gives its holder the right to purchase one share of Synthes, Inc. Common Stock. The options vest over periods ranging from immediately to five years and expire after eight to fourteen years.

The weighted average exercise price is listed in CHF since it is payable in CHF and Synthes, Inc. shares are traded on the SIX Swiss Exchange.

Following is a summary of the status of the fixed employee stock-based compensation plan during 2008 and 2007:

	Number of option shares	Weighted average exercise price per share (CHF)	Weighted average remaining contractual term (years)	Aggregate intrinsic value (in 1,000 CHF)
Outstanding at December 31, 2007	250,000	124.7	5.8	3,970
Granted	150,000	143.2	–	–
Exercised	(150,000)	120.9	–	–
Outstanding at December 31, 2008	250,000	138.1	8.5	(1,180)
Vested at December 31, 2008	80,000	128.1	6.3	427
Exercisable at December 31, 2008	80,000	128.1	6.3	427
Nonvested at December 31, 2008	170,000	142.9	9.6	(1,607)

	Number of option shares	Weighted average exercise price per share (CHF)	Weighted average remaining contractual term (years)	Aggregate intrinsic value (in 1,000 CHF)
Outstanding at December 31, 2006	257,500	123.2	6.6	5,695
Exercised	(7,500)	72.0	–	–
Outstanding at December 31, 2007	250,000	124.7	5.8	3,970
Vested at December 31, 2007	220,000	122.6	4.8	3,952
Exercisable at December 31, 2007	220,000	122.6	4.8	3,952
Nonvested at December 31, 2007	30,000	140.0	12.8	18

No options were granted in 2007. The weighted-average fair value of options granted in 2008, estimated on the date of grant using the Black-Scholes option pricing model was US\$ 46.01, using the following assumptions:

Assumption	2008
Dividend yield	0.63%
Risk-free interest rate	3.40%
Expected life of options (years)	7.0
Expected volatility	25.61%

The total intrinsic value of options exercised during the years ended December 31, 2008 and 2007 was US\$ 4.215 million and US\$ 0.521 million, respectively.

The total share-based compensation cost associated with stock options, that has been recognized in results of operations, was US\$ 1.794 and US\$ 2.192 million for fiscal 2008 and 2007, respectively. The total income tax benefit recognized in results of operations for share-based compensation arrangements was US\$ 0.614 and US\$ 0.833 million for fiscal 2008 and 2007, respectively.

As of December 31, 2008, there was US\$ 6.832 million (pretax) / US\$ 4.811 million (net of tax) of total unrecognized compensation cost related to share-based compensation arrangements. That cost is expected to be recognized over a period of 3.6 years.

Treasury shares

Synthes, Inc. directly owned 60,150 shares and 564 shares of its own stock at December 31, 2008 and 2007, respectively. During 2008, 80,000 shares were repurchased and 20,414 shares were distributed. Zero shares were repurchased and 8,400 shares were distributed during 2007. Treasury shares are recorded at cost.

12 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. The accounting policies applied by each of the segments are the same as those described in the summary of significant accounting policies (Note B).

Reportable segments (in 1,000 US\$)

For the year ended December 31, 2008	North America	Europe	Asia Pacific	Latin America	Elimi- nations	Consolidated totals
External revenue	1,922,243	824,693	308,986	136,622	–	3,192,544
Intersegment revenue	104,859	461,022	–	–	(565,881)	–
Interest income	7,786	4,243	301	291	–	12,621
Interest expense	1,347	6,252	64	297	–	7,960
Depreciation and amortization	145,638	114,809	30,930	8,030	(39,931)	259,476
Segment operating income	764,011	369,965	(6,226)	17,768	(65,374)	1,080,144
Income tax expense (benefit)	279,521	43,860	1,690	1,688	(6,834)	319,925
Segment net earnings	500,139	299,285	(8,590)	5,558	(61,428)	734,964
Segment total assets	2,013,709	3,452,325	500,411	152,797	(221,984)	5,897,258
Expenditures for long-lived assets	192,946	113,001	31,073	9,234	(64,775)	281,479

Reportable segments (in 1,000 US\$)

For the year ended December 31, 2007	North America	Europe	Asia Pacific	Latin America	Elimi- nations	Consolidated totals
External revenue	1,721,006	685,373	248,395	104,943	–	2,759,717
Intersegment revenue	67,781	337,527	–	1	(405,309)	–
Interest income	9,598	4,459	406	157	–	14,620
Interest expense	4,023	6,578	76	189	–	10,866
Depreciation and amortization	126,151	100,957	23,419	6,868	(25,416)	231,979
Segment operating income	665,564	245,077	(13,176)	10,320	(3,154)	904,631
Income tax expense (benefit)	266,171	45,769	173	5,861	(2,278)	315,696
Segment net earnings	433,109	192,218	(12,639)	3,908	(3,998)	612,598
Segment total assets	1,569,924	3,128,272	463,795	143,583	(117,601)	5,187,973
Expenditures for long-lived assets	224,639	85,299	28,658	8,827	(26,183)	321,240

Geographic information

Revenues, which are based on the location of the customer, and property, plant and equipment, net in the United States and other countries, for the years ended December 31, 2008 and 2007, respectively, are as follows:

	2008 in 1,000 US\$	2007 in 1,000 US\$
Revenues		
United States	1,862,293	1,666,915
Rest of the world	1,330,251	1,092,802
Totals	3,192,544	2,759,717
Property, plant and equipment, net		
United States	286,303	271,147
Switzerland	243,774	218,483
Rest of the world	113,773	113,732
Totals	643,850	603,362

13 Personnel expenses

Personnel expenses were as follows:

	For the year ended December 31	
	2008	2007
	<i>in 1,000 US\$</i>	<i>in 1,000 US\$</i>
Wages and salaries	887,866	770,060
Social Security costs	95,125	67,184
Pension costs – defined benefit plans	10,574	11,416
Pension costs – defined contribution plans	19,624	28,239
Other, including training and education	62,747	46,641
	1,075,936	923,540

14 Research and development expense

Research and development costs are charged to operations when incurred and are included in operating expenses. For the years ended December 31, 2008 and 2007, they amounted to US\$ 169.9 million and US\$ 148.6 million, respectively, and consist of the cost of personnel, material, depreciation and related overhead cost. They are 5.32% and 5.39% of sales for the years ended December 31, 2008 and 2007, respectively.

15 Earnings per share (EPS)

The following is a calculation of basic and diluted earnings per share for the years ended December 31, 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 year ended December 31	
	2008	2007
	<i>in 1,000 US\$</i>	<i>in 1,000 US\$</i>
Net earnings	734,964	612,598
	<i>in 1,000 of shares</i>	<i>in 1,000 of shares</i>
Weighted average number of common shares used in basic EPS	118,698	118,695
Effect of dilutive equity incentive plan stock options	25	38
Weighted average number of common shares and dilutive potential common shares used in diluted EPS	118,723	118,733
Basic EPS of common stock (expressed in US\$)	6.19	5.16
Diluted EPS of common stock (expressed in US\$)	6.19	5.16

16 Total personnel

The number of personnel employed by the Group at December 31, 2008 and 2007 was 9,947 and 9,070, respectively. The average number of personnel employed during the period was 9,509 and 8,761, for the years ended December 31, 2008 and 2007, respectively.

17 Related party transactions

The Group has entered into transactions in the normal course of business with related parties, including affiliated companies controlled by a major shareholder of the Group, and the AO Foundation ("AO"). Transactions in 2008 and 2007 between the Group and related parties are summarized below:

1. The Group leases buildings and certain other assets from various related parties, which are classified as both operating and capital leases. The operating leases provide for minimum aggregate rentals of US\$ 2.4 million through November 2021, plus contingent annual rental adjustments based on the United States Consumer Price Index. The capital lease, where the related assets and liabilities have been recorded, provides for minimum aggregate lease payments of US\$ 5.2 million through November 2021, plus contingent annual rental adjustments also based on the United States Consumer Price Index.
2. The Group has a non-interest-bearing loan receivable from an affiliate for approximately US\$ 3.4 million and US\$ 2.1 million at December 31, 2008 and 2007, respectively. This loan is secured by an assignment of the cash surrender value or the proceeds of insurance policies of the affiliate.
3. Following is a summary of transactions and balances with the Group's related parties for 2008 and 2007:

	2008	2007
	<i>in 1,000 US\$</i>	<i>in 1,000 US\$</i>
Lease payments to related parties	3,331	3,278
Due from related parties (included in the accompanying consolidated balance sheets)	8	46
Purchases from related parties	–	331

4. The Group paid consideration fees to the AO. Consideration fees paid during 2008 and 2007 were US\$ 46.8 million and US\$ 37.0 million, respectively.

Contributions to defined contribution plans for officers and directors

Contributions to defined contribution plans for officers and directors were US\$ 0.052 million and US\$ 0.051 million in 2008 and 2007, respectively.

Equity compensation benefits to officers and directors

The aggregate number of shares issued to the officers and directors of the Group during 2008 and 2007 were 20,414 shares and 25,500 shares, respectively. In 2008 and 2007, charges to operations related to the issuance of these shares were US\$ 2.8 million and US\$ 3.2 million, respectively.

The outstanding number of share options issued to the officers and directors of the Group was 200,000 and 50,000 options at the end of 2008 and 2007, respectively.

Officers' and directors' remuneration

In 2008 and 2007, the total remuneration of the officers and directors was US\$ 14.2 million and US\$ 13.0 million, respectively.

18 Comprehensive income

Comprehensive income is the total of net income plus all other changes in net assets arising from nonowner sources, which are referred to as "other comprehensive income."

Changes in the components of other comprehensive income and in accumulated other comprehensive income for 2008 and 2007 are as follows (in 1,000 US\$):

	Foreign currency translation adjustment	Defined benefit pension plans, net of taxes	Unrealized gains (losses) on foreign currency hedges	Accumulated other comprehensive income
	US\$	US\$	US\$	US\$
Balance at December 31, 2006	148,883	(21,962)	59	126,980
Change during 2007	179,824	14,455	(29)	194,250
Balance at December 31, 2007	328,707	(7,507)	30	321,230
Change during 2008	141,984	(21,346)	(1,268)	119,370
Balance at December 31, 2008	470,691	(28,853)	(1,238)	440,600

19 Fully consolidated companies

The following is a list of fully consolidated companies, all of which are unlisted, as of December 31, 2008:

Name, domicile	Country	Percentage held	Nominal share capital in 1,000	
Synthes Argentina S.A., Buenos Aires	Argentina	100	ARS	400
Synthes Australia Pty., Ltd., North Ride NSW	Australia	100	AUD	10
Synthes Oesterreich GmbH, Salzburg	Austria	100	EUR	2,000
Stratec Medical S.A., Brussels	Belgium	100	EUR	62
Synthes, Brussels	Belgium	100	EUR	250
Synthes Industria e Comercio Ltda., Rio Claro	Brazil	100	BRL	10,745
Synthes Canada, Ltd., Mississauga, Notario	Canada	100	CDN	50
Synthes Colombia S.A., Bogota	Colombia	100	COP	594,000
Synthes Costa Rica SCR, Ltda., San Jose	Costa Rica	100	CRC	103,204
Synthes. s.r.o., Praha	Czech Republic	100	CZK	65,100
Synthes A/S, Herlev	Denmark	100	DKK	502
Synthes Oy, Helsinki	Finland	100	EUR	34
Stratec Medical S.A.S., Paris	France	100	EUR	760
Synthes, Etupes Cedex	France	100	EUR	9,131
Spine Solutions GmbH, Tuttlingen	Germany	100	EUR	25
Synthes Deutschland Holding GmbH, Umkirch	Germany	100	EUR	1,023
Synthes GmbH, Umkirch	Germany	100	EUR	250
Synthes Medical Immobilien GmbH, Umkirch	Germany	100	EUR	900
Synthes Tuttlingen GmbH, Tuttlingen	Germany	100	EUR	103
Synthes Innomedic GmbH, Herxheim bei Landau	Germany	100	EUR	220
Synthes (Hong Kong) Ltd., Hong Kong	Hong Kong	100	HKD	5,000
Synthes Hong Kong Holdings Ltd., Hong Kong	Hong Kong	100	HKD	10
Stratec Medical Kft., Budapest	Hungary	100	HUF	50,000
Synthes Medical Pvt. Ltd., Haryana	India	100	INR	15,200
Stratec Medical S.p.A., Guastalla (RE)	Italy	100	EUR	156
Synthes S.r.l., Mailand	Italy	100	EUR	1,600
Synthes K.K., Tokyo	Japan	100	JPY	95,000
Synthes Korea Ltd., Seoul	Korea	100	KRW	8,050,000
Sword S.a.r.l., Luxembourg	Luxembourg	100	EUR	125
Synthes Malaysia Sdn Bhd., Selangor	Malaysia	100	MYR	200
Synthes S.M.P., S.A. de C.V., Mexico City	Mexico	100	MXP	199,018
Synthes B.V., Zeist	Netherlands	100	EUR	18
Synthes New Zealand Ltd., Auckland	New Zealand	100	NZD	51
Synthes AS, Oslo	Norway	100	NOK	200
Synthes (Shanghai) Medical Trading Co. Ltd., Shanghai	People's Republic of China	100	USD	500
Synthes Peru SAC., Lima	Peru	100	PEN	1,808
Synthes Poland Sp. zo.o., Warsaw	Poland	100	PLN	6,000
Synthes-Comercialização de dispositivos médicos, Lda., Amadora	Portugal	100	EUR	249
Synthes Ltd., Moscow	Russia	100	RUB	0.5
Synthes Singapore Pte Ltd., Singapore	Singapore	100	SGD	1,050
Synthes Proprietary Ltd., Gauteng	South Africa	100	ZAR	10
Synthes-Stratec S.A., Madrid	Spain	100	EUR	7,613
Synthes AB, Solna	Sweden	100	SEK	100
Synthes Bettlach GmbH, Bettlach	Switzerland	100	CHF	2,000
Synthes Bettlach Holding GmbH, Bettlach	Switzerland	100	CHF	2,000
Synthes Finanz AG, Bettlach	Switzerland	100	CHF	1,000
Synthes GmbH, Oberdorf	Switzerland	100	CHF	1,000
Synthes Hägendorf GmbH, Hägendorf	Switzerland	100	CHF	350

Name, domicile	Country	Percentage held	Nominal share capital in 1,000
Synthes Holding AG, Solothurn	Switzerland	100	CHF 507,800
Synthes Mezzovico GmbH, Mezzovico	Switzerland	100	CHF 400
Synthes Raron GmbH, Raron	Switzerland	100	CHF 763
Synthes Almaco AG, Balsthal	Switzerland	100	CHF 100
Synthes Almaco Holding AG, Balsthal	Switzerland	100	CHF 100
Synthes Medical Taiwan Ltd., Taipei	Taiwan	100	TWD 25,000
Synthes Tibbi Cihazlar Sanayi Ve Ticaret Limited, Istanbul	Turkey	100	TRY 5
Synthes Ltd, Hertfordshire	United Kingdom	100	GBP 20
HFSC Company	USA	100	Partnership
Norian Corporation	USA	100	USD –
SIPC, L.P.	USA	100	Partnership
SMGT, Inc.	USA	100	USD –
Spine Solutions, Inc.	USA	100	USD –
Subsidiary Canada, Inc.	USA	100	USD –
Synthes (U.S.A.)	USA	100	Partnership
Synthes (U.S.A.) L.P.	USA	100	Partnership
Synthes (U.S.A.), Inc.	USA	100	USD –
Synthes Corporate, Inc.	USA	100	USD –
Synthes LAT, Inc.	USA	100	USD –
Synthes North America, Inc.	USA	100	USD –
Synthes Spine Company, L.P.	USA	100	Partnership
Synthes Spine, Inc.	USA	100	USD –
N Spine, Inc.	USA	100	USD –
SYTH, Inc.	USA	100	USD –

20 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 was made for the purpose of enabling the Group to strengthen its position in the treatment of spinal disorders, expand its core pedicle screw business and add a platform for further product development in this field. The acquisition price included US\$ 32.7 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 December 31, 2008, 85% 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.

The purchase price has been allocated to the fair value of the assets acquired and liabilities assumed. Synthes used an independent appraisal firm to determine the fair value of the identified intangible assets acquired.

The allocation of the purchase consideration of US\$ 65.2 million, including US\$ 32.7 million of cash consideration at closing and US\$ 32.5 million accrued for contingent milestone payments, based on fair values, is as follows:

	<i>in 1,000 US\$</i>
Current assets, primarily cash, accounts receivable and inventory	2,779
Property and equipment	106
Amortizable intangible assets	25,400
Goodwill arising in the acquisition	39,675
Other liabilities, net deferred income taxes	(5,553)
Acquired in-process research and development expense	2,800
Total consideration	65,207

The acquisition was accounted for under the purchase method of accounting. The operating results of the acquired business are included in the Group's consolidated results of operations from the date of acquisition. Pro forma information, assuming that N Spine, Inc. had been acquired at the beginning of 2006, is not provided as it is not material to the Group's results of operations.

Of the intangible assets acquired, US\$ 2.8 million was assigned to research and development assets; this amount was subsequently charged against earnings and included in research and development expense, because, in the Group's judgment, such assets to be used in a particular research and development project have no alternative future use. The US\$ 25.4 million balance of acquired intangibles has been assigned to existing product & core technology and is being amortized over the weighted-average estimated useful life of 10 years. It is not anticipated that such assets will have significant residual values. Goodwill of US\$ 39.7 million arising in the acquisition has been allocated to the North America reportable segment. Of the total amount of goodwill, zero is expected to be deductible for income tax purposes.

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 December 31, 2008, the Group has paid approximately 94% of the additional contingent consideration.

21 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. 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 300.00 million (US\$ 242.8 million), and CHF 21.5 million (US\$ 17.4 million) including the as-

sumption of certain liabilities and transaction costs net of imputed interest. The future payments are due as follows:

Year ending December 31	Amount <i>in 1,000 US\$</i>
2009	47,251
2010	47,251
2011	47,252
2012	23,626
Total installment payments	165,380
Less: amount representing interest	(9,403)
Present value of installment payments	155,977

The purchase price has been allocated to the acquired assets based on their relative fair values as shown in Note C4.

The AO will continue the mission of educating surgeons, conducting basic and clinical research and providing technical services to assure the safety and efficacy of osteosynthesis products.

A fairness opinion was provided by Credit Suisse to the Group.

22 Fair value measurement

Derivatives

The Group has entered into forward exchange contracts to minimize the impact of currency fluctuation on transactions and cash flows. Some of these contracts have been designated as cash flow hedges. The amount of deferred losses as of December 31, 2008 that will be recognized in earnings in 2009 is estimated at approximately US\$ 1.2 million. The remainder of these contracts have not been designated as hedges and changes in their fair value have been recorded currently in the consolidated statements of operations in "foreign exchange (losses) gains." At December 31, 2008 and 2007, the net fair value of these derivatives was a US\$ 16.2 million gain and US\$ 15.5 million loss, respectively.

The Group does not have any interest rate derivatives outstanding as of December 31, 2008 and 2007.

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 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 and counterparty credit risk. The fair value hierarchy consists of the following three levels:

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 unobservable.

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 December 31, 2008 and the basis for that measurement (in 1,000 US\$):

	Total Fair Value Measurement December 31, 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⁾	29,751	–	29,751	–
Liabilities:				
Derivative liabilities ⁽²⁾	13,560	–	13,560	–

⁽¹⁾ Contained within prepaid expenses and other current assets in the consolidated balance sheet as of December 31, 2008.

⁽²⁾ Contained within accrued expenses other, and other long-term liabilities in the consolidated balance sheet as of December 31, 2008.

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\$ 6.8 million and US\$ 5.8 million in realized losses for the years ended December 31, 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 2008 realized loss will be recouped as the loan is repaid and/or the Swiss Franc weakens. The 2008 losses were attributable to the strengthening of the Swiss Franc.

23 Summary of Director and Group Management Committee Compensation for 2008

Name	Position	Salary & Con-	Directors	Bonus	Other ⁽¹⁾	Share Awards Earned		Total
		sulting Fees	Fees	Payments		Number	Amount	
		in 1,000 US\$	in 1,000 US\$	in 1,000 US\$	in 1,000 US\$	of Shares	in 1,000 US\$	in 1,000 US\$
Dr. h.c. mult. Hansjörg Wyss, MD	Chairman - Executive	650	–	3,151	154	13,000	1,643	5,598
Mr. Charles Hedgepeth	Vice Chairman - Non-Executive	–	11	–	9	1,700	215	235
Mr. Robert Bland	Director - Non-Executive	–	27	–	–	1,500	190	217
Dr. Roland Brönnimann ⁽²⁾	Director - Non-Executive	155	11	–	22	2,900	367	555
Dr. David Helfet ⁽³⁾	Director - Non-Executive	90	16	–	–	1,500	190	296
Mr. Amin Khoury	Director - Non-Executive	–	17	–	–	1,500	190	207
Dr. Allen Misher ⁽⁴⁾	Director - Non-Executive	–	11	–	–	600	76	87
Mr. André Mueller	Director - Non-Executive	–	27	–	–	1,500	190	217
Mr. Felix Pardo	Director - Non-Executive	–	27	–	–	1,500	190	217
Mr. Jobst Wagner	Director - Non-Executive	–	16	–	–	1,500	190	206
Ms. Amy Wyss	Director - Non- Executive	–	4	–	–	1,200	152	156
		895	167	3,151	185	28,400	3,593	7,991

⁽¹⁾ Includes retirement, health payments and other perquisites and compensation benefits paid during the year.

⁽²⁾ Dr. Roland Brönnimann provides consulting services to the company in addition to his work as a Director. A portion is paid in cash and a portion is paid in stock.

⁽³⁾ Dr. David Helfet was paid US\$ 90,000 in lecture fees.

⁽⁴⁾ Dr. Allen Misher resigned from the Board of Directors in April 2008. There are no further payments owed to him.

In the aggregate, the compensation paid to the members of the Group Management Committee in fiscal year 2008 amounted to US\$ 11.9 million.

24 Risk assessment disclosures

The Corporate Risk Management function coordinates and aligns the risk management processes, and reports to the Board of Directors and Audit Committee on a regular basis on risk assessment and risk management. Organizationally, the responsibility for risk assessment and management is allocated to the divisions, with specialized corporate functions such as compliance, finance, operations, legal, quality, regulatory and information technology providing support and controlling the effectiveness of the risk management by the divisions.

Financial risk management is described in more detail in Notes B16, B17 and B18 to the Group's consolidated financial statements.

Synthes, Inc. and Subsidiaries

Note to Directors and Shareholders

Holding company financial statements and footnotes are a Swiss Stock Exchange (SIX Swiss Exchange) requirement for Swiss companies. As Synthes, Inc. is a Delaware (U.S.A.) company, and not subject to these requirements, we have elected to omit the holding company financial statements and footnotes in the 2008 annual report of Synthes, Inc.

A proposal by the Board of Directors for the dividends to be paid in 2009 follows on the next page.

Synthes, Inc. and Subsidiaries

Proposal by the Board of Directors for the Dividends

	<i>in 1,000 US\$</i>
Beginning additional paid-in capital and retained earnings at December 31, 2007	3,764,697
Increase in additional paid-in capital in 2008	11
Profit for 2008	734,964
Dividends paid in 2008	(107,908)
Proposed dividends in 2009	(123,345)
Additional paid-in capital and retained earnings after proposed dividends	4,268,419

The proposed aggregate amount of dividends is of a preliminary nature as it is calculated on the basis of all registered shares being issued on December 31, 2008 (118,717,913 registered shares), less treasury shares (60,150). Note that due to further increases in share capital out of conditional capital, the aggregate amount of dividends will be determined on the basis of the number of shares issued as of March 25, 2009 (each and all of the outstanding shares are entitled to an individual dividend of CHF 1.1000/US\$ 1.0395 per share).

Synthes, Inc. is a Delaware (U.S.A.) company and, therefore, is permitted to include additional paid-in capital with retained earnings in its determination of surplus for paying dividends.

Synthes, Inc. and Subsidiaries

Investor Key Data

Capital structure

The share capital of Synthes, Inc. as of December 31, 2008 and 2007 consisted of 118,717,913 and 118,699,793 registered shares issued (118,657,763 and 118,699,229 registered shares outstanding), respectively, with par value of CHF 0.001 per share and stated capital of CHF 0.50 per share. Each share holds one vote.

The total number of shares which Synthes, Inc. is authorized to issue under the Certificate of Incorporation is 150,150,000 shares denominated in Swiss Francs divided into two classes as follows:

150,000,000 shares of Common Stock, par value CHF 0.001 per share and stated capital of CHF 0.50 per share.

150,000 shares of Preferred Stock, par value CHF 0.01 per share and stated capital of CHF 5.00 per share.

On April 4, 2000, at the first general meeting of the shareholders, an equity incentive plan was approved and adopted. This plan will allow for compensation of senior executives in accordance with international practices. Under the terms of the equity incentive plan, the Group may issue up to 1,500,000 shares of Common Stock CHF 0.001 par value and CHF 0.50 stated capital per share. The shareholders waived their preemptive rights in this respect.

Preferred Stock is authorized only for issuance upon exercise of rights issued pursuant to the Synthes Shareholders' Rights plan, designed to protect minority shareholders in a takeover situation.

Development of share price

During the year 2008, the Synthes, Inc. share price decreased by 5.1% to CHF 133.4 per share. This performance compares to the development of the Swiss Market Index (SMI) which decreased by 34.8% during the same period. The share price saw its low on October 10, 2008 when it hit CHF 128.3 and reached its high of CHF 157.8 on September 12, 2008. The average share price for 2008 was CHF 142.2.

Price comparison Synthes shares (SYST) – Swiss Market Index (SMI)



	2003*	2004*	2005	2006	2007	2008
Net Earnings per Share (US\$)	2.68	3.17	3.79	4.38	5.16	6.19

* Pro forma: includes the former Mathys organization and Spine Solutions Inc. as if the acquisitions by Synthes had occurred at the beginning of 2003.

Restrictions subject to US Securities Law

Synthes management believes certain statements in this annual report may constitute “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. These statements include but are not limited to those with respect to the potential for Synthes to offer new products and market existing ones, as well as the expected revenues and revenue growth of Synthes. These statements are made on the basis of management’s views and assumptions regarding future events and business performance as of the time the statements are made. Actual results may differ materially from those expressed or implied. Such differences may result from the ability of Synthes to successfully develop and introduce new products and services and market existing products and services in a competitive marketplace and changes in the economic conditions that may affect the performance of the operations of Synthes. In addition, changes in competitive conditions and regulatory developments may affect future business performance, and changing market conditions may affect the valuation of Synthes securities.

In addition, it should be noted that past financial and operational performance of the company is not necessarily indicative of future financial and operational performance. Synthes undertakes no obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise.

The securities of Synthes, Inc. have been offered and sold outside the United States and have not been and will not be registered under the U.S. Securities Act of 1933, as amended (“the Securities Act”). Such securities may not be offered, sold or transferred in the United States or to U.S. persons (as defined in regulations of the Securities Act), except pursuant to a registration statement filed under the Securities Act or under an applicable exemption under the Securities Act. Hedging transactions involving such securities may not be conducted unless in compliance with the Securities Act. The Synthes securities are deemed “restricted securities” as that term is defined in rule 144 under the Securities Act.

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