Financial Review 2007

SYNTHES®

Financial Review

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, 2007 and 2006, 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, 2007 and 2006, 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 B20 and C5 to the consolidated financial statements, the Group adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes,* effective January 1, 2007.

Ernst + Young LLP

Philadelphia, Pennsylvania
February 14, 2008,
except for Note C10,
as to which the date is
February 25, 2008

Synthes, Inc. and Subsidiaries

Consolidated Balance Sheets as of December 31, 2007 and 2006

Assets **Current assets**	**2007** *in 1,000 US$*	**2006** *in 1,000 US$*
Cash and cash equivalents	544,882	289,987
Accounts receivable		
Trade, less allowance of US$ 21.1 million and US$ 12.5 million in 2007 and 2006, respectively	483,227	437,029
Other	44,526	46,782
Inventories, net	439,978	455,376
Prepaid expenses and other current assets	41,688	9,979
Deferred income taxes	34,090	47,406
Total current assets	**1,588,391**	**1,286,559**
Property, plant and equipment, net	**603,362**	**544,983**
Other assets		
Intangible assets, less accumulated amortization of US$ 137.7 million and US$ 94.6 million in 2007 and 2006, respectively	1,843,092	1,743,267
Goodwill	1,051,253	911,633
Other assets	26,636	22,725
Deferred income taxes	75,239	40,110
Total other assets	**2,996,220**	**2,717,735**
Total assets	**5,187,973**	**4,549,277**

Liabilities and stockholders' equity **Current liabilities**	**2007** *in 1,000 US$*	**2006** *in 1,000 US$*
Current maturities of long-term debt	11,109	158,807
Accounts payable	43,815	44,257
Income taxes payable	139,638	66,237
Accrued expenses	316,548	281,618
Current acquisition-related liabilities	70,961	95,806
Deferred income taxes	26,585	26,119
Total current liabilities	**608,656**	**672,844**
Long-term debt, net of current maturities	3,127	14,163
Long-term acquisition-related liabilities	180,459	205,598
Other long-term liabilities	45,967	40,988
Deferred income taxes	263,791	236,005
Minority interests	–	1,029
Total liabilities	**1,102,000**	**1,170,627**
Stockholders' equity		
Common stock CHF 0.001 par value; shares authorized – 150,000,000; shares issued – 2007 – 118,699,793; 2006 – 118,675,733; shares outstanding – 2007 – 118,699,229; 2006 – 118,666,769	79	79
Additional paid-in capital	1,929,991	1,924,756
Treasury stock – at cost	(33)	(525)
Retained earnings	1,834,706	1,327,360
Accumulated other comprehensive income	321,230	126,980
Total stockholders' equity	**4,085,973**	**3,378,650**
Total liabilities and stockholders' equity	**5,187,973**	**4,549,277**

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, 2007 and 2006

	2007	2006
	in 1,000 US$	*in 1,000 US$*
Net sales	**2,759,717**	**2,391,595**
Cost of goods sold	524,996	433,731
Gross profit	**2,234,721**	**1,957,864**
Operating expenses		
Selling and promotion	802,285	704,594
General and administrative	294,629	266,418
Research and development	148,640	125,605
Royalty expense	46,257	68,837
Amortization of intangible assets	38,279	29,828
	1,330,090	**1,195,282**
Operating income	**904,631**	**762,582**
Other income (expenses)		
Interest expense	(10,866)	(9,291)
Interest income	14,620	9,354
Foreign exchange gains	13,791	5,766
Other, net	6,118	(4,264)
	23,663	**1,565**
Earnings before minority interest and income taxes	**928,294**	**764,147**
Minority interest income	–	(687)
Earnings before income taxes	**928,294**	**764,834**
Income taxes	315,696	256,037
Net earnings	**612,598**	**508,797**
Basic and diluted earnings per share (expressed in US$)	**5.16**	**4.38**
	in 1,000 of shares	*in 1,000 of shares*
Weighted average number of common shares outstanding	**118,695**	**116,236**
Weighted average number of common shares outstanding with dilutive effect	**118,733**	**116,275**

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, 2007 and 2006

	Common stock		Additional paid-in capital	Treasury stock	Retained earnings	Accumulated other comprehensive income (loss)	Total Stockholders' equity	Comprehensive income (loss)
	in 1,000 of shares	*in 1,000 US$*	*in 1,000 US$*	*in 1,000 US$*	*in 1,000 US$*	*in 1,000 US$*	*in 1,000 US$*	*in 1,000 US$*
Balance December 31, 2005	**114,947**	**76**	**1,512,932**	**(590)**	**880,797**	**(5,800)**	**2,387,415**	**153,737**
Net earnings 2006	–	–	–	–	508,797	–	508,797	508,797
Issuance of common stock in connection with asset acquisition	3,705	3	407,481	–	–	–	407,484	–
Issuance of common stock	24	–	2,717	–	–	–	2,717	–
Re-issuance of treasury shares	–	–	75	65	–	–	140	–
Dividends CHF 0.7000 (US$ 0.5414) per share	–	–	–	–	(62,234)	–	(62,234)	–
Share-based payment arrangements compensation	–	–	1,551	–	–	–	1,551	–
Minimum pension liability adjustment, net of deferred taxes of US$ (2.727) million	–	–	–	–	–	4,524	4,524	4,524
Cumulative adjustment to initially apply SFAS 158, net of deferred taxes of US$ 2.475 million	–	–	–	–	–	(10,172)	(10,172)	–
Unrealized gains on foreign currency hedges	–	–	–	–	–	59	59	59
Foreign currency translation adjustment 2006	–	–	–	–	–	138,369	138,369	138,369
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**

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, 2007 and 2006

Cash flows from operating activities	**2007** *in 1,000 US$*	**2006** *in 1,000 US$*
Net earnings	612,598	508,797
Adjustments to reconcile net earnings to net cash provided by operating activities		
Depreciation	193,662	167,330
Amortization	38,317	31,384
Share-based compensation	4,254	4,121
Provisions for inventory obsolescence	54,512	24,398
Provisions for doubtful accounts	7,662	3,272
Deferred income tax benefit	(14,629)	(37,732)
Losses on sale of property, plant and equipment	2,705	2,989
Other	(10,988)	(6,338)
Changes in assets and liabilities, net of effects of business acquisitions		
Accounts receivable trade	(39,625)	(66,187)
Accounts receivable other	5,611	(24,242)
Inventories	(26,552)	(119,347)
Prepaid expenses and other current assets	(5,915)	(1,424)
Accounts payable	(957)	(1,719)
Income taxes payable	22,776	201
Accrued expenses	25,182	39,119
Net cash provided by operating activities	**868,613**	**524,622**

Cash flows from investing activities	**2007** *in 1,000 US$*	**2006** *in 1,000 US$*
Capital expenditures for property, plant and equipment	(223,061)	(190,284)
Consideration in connection with a prior asset acquisition	(104,188)	–
Contingent consideration related to a prior acquisition	(26,952)	(79,903)
Purchase of minority interest	(2,500)	(4,433)
Proceeds from sale of minority interest	–	798
Proceeds from disposal of property, plant and equipment	988	1,291
Business acquisitions, net of cash acquired	(36,562)	–
Asset acquisition	–	(103,919)
Investment in nonconsolidated investments and other long-term assets	(1,708)	(3,815)
Disposals of nonconsolidated investments and other long-term assets	1,347	6,248
Issuance of loans	(331)	(1,470)
Proceeds from loans	6,293	–
Net cash used in investing activities	**(386,674)**	**(375,487)**
Cash flows from financing activities		
Principal payments of debt and capital lease obligations	(165,669)	(174,577)
Proceeds from issuance of long-term debt	–	7,560
Proceeds from issuance of common stock in connection with stock options	433	146
Dividends paid to stockholders	(73,436)	(62,234)
Excess tax benefits from share-based arrangements	182	57
Net cash used in financing activities	**(238,490)**	**(229,048)**
Effect of exchange rate changes on cash and cash equivalents	11,446	1,411
Net increase (decrease) in cash and cash equivalents	**254,895**	**(78,502)**
Cash and cash equivalents as of January 1	289,987	368,489
Cash and cash equivalents as of December 31	**544,882**	**289,987**
Supplemental disclosures of cash flow information		
Interest paid	4,025	8,528
Income taxes paid	288,786	303,412
Noncash transactions		
Accrual of contingent consideration related to business acquisition	32,463	–
Issuance of common stock in connection with asset acquisition	–	407,484
Accrual of future consideration in connection with asset acquisition	–	301,404

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

Synthes, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements December 31, 2007 and 2006

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, 2007). 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 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 at December 31		Weighted average rates for year ended December 31	
		2007	**2006**	**2007**	**2006**
CHF	1 =	0.8813	0.8173	0.8335	0.7981
CDN	1 =	1.0202	0.8617	0.9338	0.8818
GBP	1 =	1.9960	1.9593	2.0007	1.8415
SEK	100 =	15.6100	14.5500	14.8096	13.5436
NOK	100 =	18.3800	15.9490	17.0975	15.6138
DKK	100 =	19.7400	17.6400	18.3778	16.8253
MXN	100 =	9.1900	9.1840	9.1574	9.1885
CZK	100 =	5.5370	4.7800	4.9443	4.4492
HUF	100 =	0.5790	0.5220	0.5459	0.4769
EUR	1 =	1.4655	1.3139	1.3692	1.2554
ARS	1 =	0.3179	0.3258	0.3218	0.3272
BRL	1 =	0.5682	0.4680	0.5154	0.4606
COP	100 =	0.0500	0.0460	0.0493	0.0436
PLN	100 =	40.8630	34.3230	36.2708	32.2382
AUD	1 =	0.8758	0.7872	0.8380	0.7533
CNY	1 =	0.1371	0.1281	0.1316	0.1255
HKD	1 =	0.1282	0.1286	0.1282	0.1287
IDR	100 =	0.0110	0.0110	0.0110	0.0128
INR	1 =	0.0254	0.0226	0.0242	0.0221
JPY	100 =	0.8830	0.8420	0.8493	0.8600
KRW	100 =	0.1070	0.1090	0.1084	0.1065
MYR	1 =	0.3013	0.2832	0.2919	0.2737
NZD	1 =	0.7722	0.7033	0.7359	0.6500
RUB	100 =	4.0770	3.7950	3.9105	3.6797
SGD	1 =	0.6909	0.6512	0.6637	0.6294
THB	100 =	3.3620	2.8200	3.1246	2.6427
TWD	100 =	3.0780	3.0610	3.0438	3.0720
ZAR	1 =	0.1462	0.1420	0.1422	0.1494
PEN	1 =	0.3379	0.3243	0.3268	0.3140
CRC	100 =	0.2050	0.2000	0.1988	0.2016

3 Reclassifications

Certain 2006 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.

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 whether 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.

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 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.

13 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 B20 and C5.

14 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 10 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: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of July 1, 2005, based on the grant date fair value estimated in accordance with the original provisions of FASB Statement 123, and (b) compensation cost for all share-based payments granted subsequent to July 1, 2005, based on the grant-date fair value estimated in accordance with the provisions of Statement 123(R).

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

16 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.

17 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 2007 and 2006, 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 "other, net" (Note C22).

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

18 Advertising costs

Advertising and promotion costs are expensed as incurred, and were US$ 40.7 million and US$ 38.6 million in 2007 and 2006, respectively.

19 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, competition and legislation that may cause actual results to differ from estimated results.

20 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. The Group is currently evaluating the potential effect of adoption of SFAS 157.

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, "postretirement 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 will not change the calculation of the amount of net periodic benefit cost included in net earnings. On December 31, 2006, the Group adopted the recognition and disclosure provisions of SFAS 158 with the exception of SFAS 158's provisions regarding the change in the measurement date. See Note C9 for further discussion on the effect of adopting SFAS 158. The measurement date was changed to December 31 in 2007.

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 Nov. 15, 2007. The Group is currently evaluating the potential effect of adoption of SFAS 159.

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. The Group is currently evaluating the potential effect of adoption of SFAS 141(R) and SFAS 160.

Synthes, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements December 31, 2007 and 2006

Note C – Footnotes

1 Accounts receivable other

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

	2007 *in 1,000 US$*	2006 *in 1,000 US$*
Refundable taxes, principally value added tax (V.A.T.)	28,334	31,289
Deposits	2,187	2,245
Due from officers, directors and employees	3,478	1,979
All other	10,527	11,269
	44,526	**46,782**

2 Inventories

Inventories are summarized at December 31, as follows:

	2007 *in 1,000 US$*	2006 *in 1,000 US$*
Raw materials	74,345	79,888
Work-in-progress and semi-finished products	95,740	99,197
Finished products	303,981	295,030
Customer consignment stock	51,663	33,539
Gross value	**525,729**	**507,654**
Less provision for obsolescence	(85,751)	(52,278)
Net value	**439,978**	**455,376**

3 Property, plant and equipment

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

	2007 *in 1,000 US$*	2006 *in 1,000 US$*
Land and buildings	236,474	194,868
Machines and fixtures	360,710	297,232
Office equipment, field equipment and vehicles	823,053	661,778
	1,420,237	**1,153,878**
Less: accumulated depreciation	(839,560)	(639,005)
	580,677	**514,873**
Construction in progress	22,685	30,110
	603,362	**544,983**

Depreciation expense recorded in the consolidated statements of operations was US$ 193.7 million and US$ 167.3 million in 2007 and 2006, respectively.

4 Intangible assets

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

	December 31, 2007		
	Total *in 1,000 US$*	**Gross amount** *in 1,000 US$*	**Accumulated amortization** *in 1,000 US$*
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)**

	December 31, 2006		
	Total *in 1,000 US$*	**Gross amount** *in 1,000 US$*	**Accumulated amortization** *in 1,000 US$*
Finite lived:			
Product intangible assets	60,000	80,000	(20,000)
Customer relationships	659,204	713,716	(54,512)
Patents/Patent rights	191,169	195,315	(4,146)
Other intangible assets	9,105	25,029	(15,924)
Subtotal – finite-lived intangible assets	919,478	1,014,060	(94,582)
Indefinite lived:			
Geographic marketing rights	204,325	204,325	–
Trade names	619,464	619,464	–
Subtotal – indefinite-lived intangible assets	823,789	823,789	–
Total – intangible assets	**1,743,267**	**1,837,849**	**(94,582)**

The increase in product intangible assets in 2007 was associated with the acquisition of N Spine, Inc. described in Note C20.

The trade names, patents and patent rights were acquired in 2006 in the asset purchase transaction described in Note C21.

The increases in gross amount of customer relationships and geographic marketing rights from December 31, 2006 to December 31, 2007 result from changes in foreign currency translation rates.

Amortization expense for intangible assets, was US$ 38.3 million and US$ 31.4 million in 2007 and 2006, respectively. Estimated amortization expense for each of the five years through December 31, 2012 is as follows (in US$ millions): 39.9, 39.8, 39.7, 39.2 and 39.0, 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:

Deferred income tax assets	**2007** *in 1,000 US$*	**2006** *in 1,000 US$*
Product liability	6,298	5,968
Net operating loss carryforwards	21,893	12,128
Inventories	47,937	49,463
Accounts receivable	11,920	3,551
Payments to employees	8,626	9,284
Other	34,378	40,644
Gross deferred income tax assets	131,052	121,038
Valuation allowance	(21,722)	(10,373)
Net deferred income tax assets	**109,330**	**110,665**
Deferred income tax liabilities		
Accelerated tax depreciation	(20,279)	(23,599)
Intangible assets	(225,416)	(219,195)
Inventories	(19,271)	(18,030)
Other	(25,411)	(24,449)
Gross deferred income tax liabilities	**(290,377)**	**(285,273)**
Net deferred income tax liabilities	**(181,047)**	**(174,608)**

At December 31, 2007, the approximate amounts and expiration of net operating loss carryforwards (primarily foreign) are as follows (in millions): 2008: US$ 2.9, 2009–2012: US$ 5.6, 2013 and later years: US$ 27.3, and US$ 27.1 have an indefinite carryforward period.

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

	2007 *in 1,000 US$*	**2006** *in 1,000 US$*
Beginning of the year	(174,608)	(195,575)
Statement of operations benefit	14,629	37,732
N Spine purchase accounting	(5,378)	–
Pension liability adjustment	(83)	–
Currency translation adjustment	(15,607)	(16,765)
End of the year	**(181,047)**	**(174,608)**

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

	2007 *in 1,000 US$*	**2006** *in 1,000 US$*
Current assets – deferred income taxes	34,090	47,406
Noncurrent assets – deferred income taxes	75,239	40,110
Current liabilities – deferred income taxes	(26,585)	(26,119)
Noncurrent liabilities – deferred income taxes	(263,791)	(236,005)
Total net deferred tax liabilities	**(181,047)**	**(174,608)**

Cumulative undistributed earnings of foreign subsidiaries, for which no U.S. income or foreign withholding taxes have been recorded, approximated US$ 398 million at December 31, 2007. 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:

	2007 *in 1,000 US$*	**2006** *in 1,000 US$*
Current taxes	330,325	293,769
Deferred tax benefit	(14,629)	(37,732)
	315,696	**256,037**

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:

	2007 *in 1,000 US$*	**2006** *in 1,000 US$*
Earnings before minority interest and income taxes	928,294	764,147
Minority interest income	–	(687)
Earnings before income taxes	**928,294**	**764,834**
Tax expense calculated at a statutory tax rate of 35%	324,903	267,692
Effect of permanent items	(2,550)	575
Effect of taxes in other countries	(32,064)	(29,364)
Impact of tax effect of minority interest	–	(240)
State income taxes, net of federal income tax benefit	19,277	21,074
Tax benefits relating to tax credits	(16,046)	(3,700)
Increase in unrecognized tax positions, net	22,176	–
Income tax expense	**315,696**	**256,037**

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 positions, defined as the aggregate tax effect of differences between tax return positions and the benefits recognized in the Group's financial statements, at January 1, 2007 is US$ 86.4 million, and the amount of accrued interest and penalties related to unresolved income tax positions is US$ 9.0 million, net of tax. The amount of net unrecognized income tax positions at January 1, 2007, all of which would impact the Group's effective tax rate upon favorable resolution, is US$ 64.0 million including accrued interest and penalties. At December 31, 2007, the amount of gross unrecognized income tax positions is US$ 92.1 million. The amount of net unrecognized income tax positions, all of which would, if recognized, change the company's effective tax rate is US$ 78.1 million including accrued interest and penalties. In 2007, expense for interest and penalties related to unresolved income tax positions amounted to US$ 10.0 million, net of tax. At December 31, 2007, accrued interest and penalties related to unresolved income tax positions were US$ 18.8 million, net of tax.

The Group operates in various tax jurisdictions both inside and outside the United States. At December 31, 2007, tax authorities in several tax jurisdictions were conducting routine audits of the Group's income tax returns filed in prior years. With few exceptions, the Group is no longer subject to audits by tax authorities for tax years prior to 2002. Tax years subsequent to 2002 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:

	in 1,000 US$
Balance, January 1, 2007	**86,372**
Increase from current year tax positions	3,936
Increase from prior years' tax positions	13,145
Decrease from prior years' tax positions	(7,309)
Decrease from settlements with taxing authorities	(4,088)
Balance, December 31, 2007	**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 2007 and 2006, by reporting unit and in the aggregate, are summarized in the following tables:

2007	**Total** *in 1,000 US$*	**North America** *in 1,000 US$*	**Europe** *in 1,000 US$*	**Asia Pacific** *in 1,000 US$*	**Latin America** *in 1,000 US$*
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

2006	**Total** *in 1,000 US$*	**North America** *in 1,000 US$*	**Europe** *in 1,000 US$*	**Asia Pacific** *in 1,000 US$*	**Latin America** *in 1,000 US$*
Balance, January 1, 2006	**853,577**	27,801	725,795	61,382	38,599
Sale of minority interest	**(1,976)**	–	–	(1,976)	–
Other	**(99)**	(99)	–	–	–
Currency translation adjustments	**60,131**	–	51,321	5,998	2,812
Balance, December 31, 2006	**911,633**	27,702	777,116	65,404	41,411

7 Long-term debt

Among other restrictions, the Group has agreed to maintain specified levels of working capital and certain financial performance ratios for various debt agreements. Details of long-term debt as of December 31, are as follows:

	2007 *in 1,000 US$*	**2006** *in 1,000 US$*
Secured loans	–	839
Unsecured loans	10,767	169,287
Other, including capital lease obligations	3,469	2,844
	14,236	**172,970**
Less: current maturities	(11,109)	(158,807)
	3,127	**14,163**

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

Year ended December 31	*in 1,000 US$*
2008	11,109
2009	320
2010	268
2011	183
2012	135
Thereafter	2,221

Details of significant debt agreements at December 31, 2007 are as follows:

Debt consists of a series of unsecured Guaranteed Senior Notes, and capital leases.

The Guaranteed Senior Notes have principal balances at December 31, 2007 and 2006 of US$ 10.7 million and US$ 21.4 million, respectively. The Guaranteed Senior Notes bear interest at a fixed rate of 6.66% and will be repaid in 2008.

As of December 31, 2007, the Group is in compliance with the financial covenants of the Guaranteed Senior Notes, and no situation existed which would constitute an event of default as defined by the respective agreements.

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 and machinery as of December 31, 2007 and a single building as of December 31, 2006. Following is a summary of property held under capital leases as of December 31:

	2007 *in 1,000 US$*	**2006** *in 1,000 US$*
Cost	6,034	3,917
Accumulated depreciation	(3,362)	(2,194)
Net book amount	**2,672**	**1,723**

The Group leases office buildings from an affiliate. One of the leases is classified as a capital lease with the related asset and liability recorded. The leases provide for minimum annual lease payments, in the aggregate, of US$ 5.6 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, 2007 for each of the next five years and in the aggregate are:

Year ended December 31	**Amount** *in 1,000 US$*
2008	399
2009	399
2010	399
2011	399
2012	399
Thereafter	3,557
Total minimum lease payments	**5,552**
Less: amount representing interest	(2,785)
Present value of minimum lease payments	**2,767**

Operating leases consist primarily of rental agreements for real estate, aircraft, machinery and office equipment expiring in various years through 2012, 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, 2007 under noncancelable operating leases having initial or remaining terms in excess of one year are:

Year ended December 31	**Amount** *in 1,000 US$*
2008	7,245
2009	5,147
2010	2,794
2011	563
2012	120
Thereafter	805
Total minimum future rental payments	**16,674**

Operating lease expense for the years ended December 31, 2007 and 2006 was US$ 14.3 million and US$ 12.1 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 2007 and 2006:

	2007 *in 1,000 US$*	**2006** *in 1,000 US$*
Pension benefit obligation		
Balance, beginning of year	(228,166)	(197,094)
Service cost	(20,939)	(17,713)
Past service cost	(659)	–
Interest cost	(6,608)	(5,707)
Curtailments/settlements	504	–
Benefits paid	8,598	2,877
New plan participants	(4,862)	(6,944)
Actuarial gains	27,267	11,307
Changes in foreign currency exchange rates	(19,434)	(14,892)
Balance, end of year	**(244,299)**	**(228,166)**
Plan assets		
Fair value, beginning of year	205,932	167,418
Actual return on plan assets	120	2,092
Company contributions	13,412	11,400
Contributions by plan participants	9,157	8,132
Changes in foreign currency exchange rates	17,751	12,823
Benefits paid to plan participants	(8,598)	(2,877)
Contributions from new plan participants	3,882	6,944
Fair value, end of year	**241,656**	**205,932**
Funded status	**(2,643)**	**(22,234)**

For 2007 and 2006, the amounts recognized in the consolidated balance sheets were classified as follows:

	2007 *in 1,000 US$*	**2006** *in 1,000 US$*
Accrued benefit (liability) – noncurrent	(2,643)	(22,234)
Accumulated other comprehensive income	7,507	21,962

The underfunded status of the plans of US$ 2.643 million and US$ 22.234 million at December 31, 2007 and 2006, 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, 2008.

The accumulated benefit obligation was US$ 232.3 million and US$ 215.0 million at December 31, 2007 and 2006, 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$ 244.3 million, US$ 232.3 million and US$ 241.7 million, respectively, as of December 31, 2007. 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$ 226.3 million, US$ 213.7 million and US$ 204.4 million, respectively, as of December 31, 2006.

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

	2007 *in 1,000 US$*	**2006** *in 1,000 US$*
Service cost	20,939	17,713
Interest cost	6,608	5,707
Expected return on plan assets	(7,984)	(6,541)
Net actuarial losses recognized during the year	450	1,499
Employee contributions	(9,157)	(8,132)
Other	560	(57)
Total pension expense, included in personnel costs	**11,416**	**10,189**

The pension plan assets include bonds, stock, real estate and cash with a total fair value of US$ 241.7 million at December 31, 2007. 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, 2007.

Principal actuarial assumptions (expressed as weighted averages):

	2007 *in %*	**2006** *in %*
Discount rate	3.50	2.75
Expected return on plan assets	4.25	3.75
Future salary increases	2.00	2.00
Future pension increases	0.50	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, 2007 and 2006 and the target allocation for 2008 are as follows:

	Target allocation	**Percentage of plan assets at December 31**	
Asset category	**2008** *in %*	**2007** *in %*	**2006** *in %*
Equity securities	25.0	24.4	26.5
Debt securities	60.0	52.9	53.4
Real estate	12.0	11.2	10.8
Other	3.0	11.5	9.3
Total	**100.0**	**100.0**	**100.0**

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. The maturities of debt securities at December 31, 2006, range from 1 to approximately 12 years with a weighted-average maturity of 4.9 years.

Pension contributions	*in 1,000 US$*
2008 (expected)	13,628

Of the US$ 13.6 million in cash expected to be contributed to the defined benefit pension plans during 2008, US$ 13.6 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, 2007, the following benefit payments, which reflect expected future service, are expected to be paid from the defined benefit pension plans:

Year ending December 31	*in 1,000 US$*
2008	5,531
2009	5,155
2010	6,116
2011	7,067
2012	7,295
2013–2017	54,471

Adoption of SFAS 158

On December 31, 2006, the Group adopted the recognition and disclosure provisions of SFAS 158. SFAS 158 required the Group to recognize the funded status (i.e., the difference between the fair value of plan assets and the projected benefit obligations) of its pension plans in the December 31, 2006 consolidated balance sheet, with a corresponding adjustment to accumulated other comprehensive income, net of tax. The adjustment to accumulated other comprehensive income at adoption represents the net unrecognized actuarial losses, unrecognized prior service costs, and unrecognized transition obligation remaining from the initial adoption of SFAS 87.

The amounts will be subsequently recognized as net periodic pension cost pursuant to the Group's historical accounting policy for amortizing such amounts. Further, actuarial gains and losses that arise in subsequent periods and are not recognized as net periodic pension costs in the same periods will be recognized as a component of other comprehensive income. Those amounts will be subsequently recognized as a component of net periodic pension cost on the same basis as amounts recognized in accumulated other comprehensive income at adoption of SFAS 158.

The incremental effects of adopting the provisions of SFAS 158 on the Group's consolidated balance sheet at December 31, 2006 are presented in the following table. The adoption of SFAS 158 had no effect on the Group's consolidated statement of operations for the year ended December 31, 2006, or for any prior period presented, and will not affect the Group's operating results in future periods. Had the Group not been required to adopt SFAS 158 at December 31, 2006, it would have recognized an additional minimum liability pursuant to the provisions of SFAS 87.

The effect of recognizing the additional minimum liability is included in the table below in the column labeled "Prior to adopting SFAS 158".

	At December 31, 2006		
	Prior to adopting SFAS 158 *in 1,000 US$*	**Effect of adopting SFAS 158** *in 1,000 US$*	**As reported at December 31, 2006** *in 1,000 US$*
Pension asset	5,238	(5,238)	–
Accrued pension liability	(14,825)	(7,409)	(22,234)
Deferred income taxes	2,838	2,475	5,313
Accumulated other comprehensive income	(11,790)	(10,172)	(21,962)

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, 2007 and 2006 was US$ 28.2 million and US$ 27.2 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 has been named as a defendant in lawsuits alleging product failure or patent infringement. Product liability cases are routinely handled by in-house and external counsel, and management does not anticipate that any material losses will be sustained by the Group as a result of these claims.

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

On March 23, 2006, the Group received a grand jury subpoena from the United States Department of Justice United States Attorney's Office in Philadelphia. Under the subpoena, the Group was ordered to deliver certain documents and information concerning Norian XR® and related products. The Group has cooperated fully in responding to the subpoena. The document requests set forth in the subpoena suggest, among other things, that the Department of Justice is investigating the promotion, sale, and reimbursement of Norian XR® for off-label uses, i.e., outside of the scope for which it was cleared by the U.S. Food and Drug Administration (FDA). At this point in the investigation, the Group does not know when the investigation will conclude or whether a sanction will be imposed. Following an FDA inspection and a warning letter dated November 5, 2004, the

Group voluntarily stopped selling Norian XR® and has had no revenues related to the product since 2004.

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

The book value of pledged assets, which includes property, plant, equipment and receivables, at December 31, 2007 and 2006 was US$ 0.0 million and US$ 18.9 million, respectively.

Capital expenditures for property, plant and equipment contracted for but not recognized in the consolidated financial statements are US$ 2.0 million and US$ 4.0 million at December 31, 2007 and 2006, respectively.

The Group has entered into a contract to purchase specific amounts of raw materials through June 2008. At December 31, 2007, the commitment under this contract was US$ 10.0 million.

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, 2007 and 2006, 118,699,793 shares and 118,675,733 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 $33\frac{1}{3}\%$ or more of the Group's Common Stock. The rights provide shareholders (except the person or persons that acquired greater than $33\frac{1}{3}\%$) 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 (SWX).

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 SWX.

Following is a summary of the status of the fixed employee stock-based compensation plan during 2007 and 2006:

	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**

	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, 2005	**210,000**	**119.5**	**5.9**	**6,096**
Granted	50,000	140.0	–	–
Exercised	(2,500)	72.0	–	–
Outstanding at December 31, 2006	**257,500**	**123.2**	**6.6**	**5,695**
Vested at December 31, 2006	**117,500**	**119.4**	**5.6**	**3,043**
Exercisable at December 31, 2006	**117,500**	**119.4**	**5.6**	**3,043**
Nonvested at December 31, 2006	**140,000**	**126.4**	**7.5**	**2,652**

No options were granted in 2007. The weighted-average fair value of options granted in 2006, estimated on the date of grant using the Black-Scholes option pricing model was US$ 56.35, using the following assumptions:

Assumption	**2006**
Dividend yield	0.50%
Risk-free interest rate	4.53%
Expected life of options (years)	9.8
Expected volatility	37.92%

The total intrinsic value of options exercised during the years ended December 31, 2007 and 2006 was US$ 0.521 million and US$ 0.162 million, respectively.

The total share-based compensation cost associated with stock options, that has been recognized in results of operations, was US$ 2.192 and US$ 1.551 million for fiscal 2007 and 2006, respectively. The total income tax benefit recognized in results of operations for share-based compensation arrangements was US$ 0.833 and US$ 0.589 million for fiscal 2007 and 2006, respectively.

As of December 31, 2007, there was US$ 1.724 million (pretax) / US$ 1.069 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 2.9 years.

Treasury shares

Synthes, Inc. directly owned 564 shares and 8,964 shares of its own stock at December 31, 2007 and 2006, respectively. During 2007, zero shares were repurchased and 8,400 shares were distributed. Zero shares were repurchased and 1,103 shares were distributed during 2006. 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, 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

	Reportable segments *(in 1,000 US$)*					
For the year ended December 31, 2006	**North America**	**Europe**	**Asia Pacific**	**Latin America**	**Elimi-nations**	**Consolidated totals**
External revenue	1,525,091	564,531	220,129	81,844	–	2,391,595
Intersegment revenue	68,887	278,848	–	–	(347,735)	–
Interest income	6,105	2,882	171	196	–	9,354
Interest expense	6,633	2,399	100	159	–	9,291
Depreciation and amortization	107,790	84,136	19,516	4,983	(17,711)	198,714
Segment operating income	586,464	193,044	5,642	4,512	(27,080)	762,582
Income tax expense (benefit)	226,815	29,020	6,577	2,422	(8,797)	256,037
Segment net earnings	370,015	160,391	(1,756)	1,411	(21,264)	508,797
Segment total assets	1,224,001	2,893,664	417,201	123,333	(108,922)	4,549,277
Expenditures for long-lived assets	193,914	104,107	21,351	5,079	(26,433)	298,018

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, 2007 and 2006, respectively, are as follows:

	2007 *in 1,000 US$*	**2006** *in 1,000 US$*
Revenues		
United States	1,666,915	1,479,668
Rest of the world	1,092,802	911,927
Totals	**2,759,717**	**2,391,595**
Property, plant and equipment, net		
United States	271,147	260,139
Switzerland	218,483	193,902
Rest of the world	113,732	90,942
Totals	**603,362**	**544,983**

13 Personnel expense

Personnel expenses were as follows:

	For the year ended December 31	
	2007	**2006**
	in 1,000 US$	*in 1,000 US$*
Wages and salaries	770,060	702,868
Social Security costs	67,184	61,189
Pension costs – defined benefit plans	11,416	10,189
Pension costs – defined contribution plans	28,239	27,191
Other, including training and education	46,641	50,455
	923,540	**851,892**

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, 2007 and 2006, they amounted to US$ 148.6 million and US$ 125.6 million, respectively, and consist of the cost of personnel, material, depreciation and related overhead cost. They are 5.39% and 5.25% of sales for the years ended December 31, 2007 and 2006, respectively.

15 Earnings per share (EPS)

The following is a calculation of basic and diluted earnings per share for the years ended December 31, 2007 and 2006. 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	
	2007	**2006**
	in 1,000 US$	*in 1,000 US$*
Net earnings	**612,598**	**508,797**
	in 1,000 of shares	*in 1,000 of shares*
Weighted average number of common shares used in basic EPS	**118,695**	**116,236**
Effect of dilutive equity incentive plan stock options	38	39
Weighted average number of common shares and dilutive potential common shares used in diluted EPS	**118,733**	**116,275**
Basic EPS of common stock (expressed in US$)	**5.16**	**4.38**
Diluted EPS of common stock (expressed in US$)	**5.16**	**4.38**

16 Total personnel

The number of personnel employed by the Group at December 31, 2007 and 2006 was 9,070 and 8,451, respectively. The average number of personnel employed during the period was 8,761 and 8,039, for the years ended December 31, 2007 and 2006, 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. Transactions in 2007 and 2006 between the Group and related parties are summarized below:

1. The Group leases buildings and certain other assets from various affiliated companies, which are classified as both operating and capital leases. The operating leases provide for minimum aggregate rentals of US$ 2.9 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$ 5.6 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$ 2.1 million and US$ 8.3 million at December 31, 2007 and 2006, 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 affiliates for 2007 and 2006:

	2007 *in 1,000 US$*	**2006** *in 1,000 US$*
Lease payments to affiliates	3,278	3,330
Due from affiliates (included in the accompanying consolidated balance sheets)	46	53
Purchases from affiliates	331	294

4. The Group paid royalties and consideration fees to the AO Foundation ("AO"). Consideration fees paid during 2007 were US$ 37.0 million. During 2006, royalties and consideration fees paid to the AO were US$ 64.7 million and US$ 8.4 million, respectively. See Note C21 for discussion of acquisition of assets from the AO during 2006.

Contributions to defined contribution plans for officers and directors

Contributions to defined contribution plans for officers and directors were US$ 0.051 million and US$ 0.048 million in 2007 and 2006, respectively.

Equity compensation benefits to officers and directors

The aggregate number of shares issued to the officers and directors of the Group during 2007 and 2006 were 25,500 shares and 72,990 shares, respectively. In 2007 and 2006, charges to operations related to the issuance of these shares were US$ 3.2 million and US$ 2.7 million, respectively.

The outstanding number of share options issued to the officers and directors of the Group was 50,000 options at the end of 2007 and 2006.

Officers' and directors' remuneration

In 2007 and 2006, the total remuneration of the officers and directors was US$ 13.0 million and US$ 12.2 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 2007 and 2006 are as follows (in 1,000 US$):

	Foreign currency translation adjustment	**Minimum pension liability adjustment, net of taxes**	**Defined benefit pension plans, net of taxes**	**Unrealized gains on foreign currency hedges**	**Accumulated other comprehensive income (loss)**
	US$	*US$*	*US$*	*US$*	*US$*
Balance at December 31, 2005	10,514	(16,314)	–	–	(5,800)
Change during 2006	138,369	4,524	–	59	142,952
Adoption of SFAS 158	–	11,790	(21,962)	–	(10,172)
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

19 Fully consolidated companies

The following is a list of fully consolidated companies, all of which are unlisted, as of December 31, 2007:

Name, domicile	Country	Percentage held		Nominal share capital in 1,000
Synthes Argentina S.A., Buenos Aires	Argentina	100	ARS	564
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	3,502
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, Tuttlingen	Germany	100	EUR	103
Synthes (Hong Kong) Ltd., Hong Kong	Hong Kong	100	HKD	5,000
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
Synthes Malaysia Sdn Bhd., Selangor	Malaysia	100	MYR	200
Synthes S.M.P., S.A. de C.V., Mexico City	Mexico	100	MXP	86,716
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-Comercializaçao 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
Almaco AG, Balsthal	Switzerland	100	CHF	100
Almaco Holding AG, Balsthal	Switzerland	100	CHF	100
Synthes Medical Taiwan Ltd., Taipei	Taiwan	100	TWD	25,000
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$ 32.4 million consisting of cash at closing and transaction costs, payments of up to US$ 45.0 million based upon the achievement of certain milestones, and additional earn-out payments based on product sales. In connection with the milestones, the Group has recorded a liability for the portion of the consideration considered payable beyond a reasonable doubt. Any additional payments of contingent consideration 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$ 64.8 million, including US$ 32.4 million of cash consideration at closing and US$ 32.4 million accrued for contingent milestone payments, based on fair values, is as follows:

	in 1,000 US$
Current assets, primarily cash, accounts receivable and inventory	1,756
Property and equipment	290
Amortizable intangible assets	25,400
Goodwill arising in the acquisition	40,266
Other liabilities, net deferred income taxes	(5,667)
Acquired in-process research and development expense	2,800
Total consideration	**64,845**

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 20 years. It is not anticipated that such assets will have significant residual values. Goodwill of US$ 40.3 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, 2007, the Group has paid approximately 91% of the additional contingent consideration.

21 Acquisition of assets

On August 28, 2006, the Group and the AO Foundation ("AO") closed the asset purchase agreement transaction which was previously announced on March 15, 2006. Under the agreement, 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 assumption of certain liabilities and transaction costs net of imputed interest. The future payments are due as follows:

Year ending December 31	**Amount** *in 1,000 US$*
2008	44,065
2009	44,065
2010	44,065
2011	44,065
2012	22,033
Total installment payments	**198,293**
Less: amount representing interest	(14,336)
Present value of installment payments	**183,957**

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 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 gains as of December 31, 2007 that will be recognized in earnings in 2008 is estimated at less than US$ 0.1 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 "other net." At December 31, 2007 and 2006, the net fair value of these derivatives were losses of US$ 15.5 million and US$ 3.7 million, respectively.

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

23 Summary of Director and Group Management Committee Compensation for 2007

Name	Position	Base Salary in 1,000 US$	Cash Fees *in 1,000 US$*	Bonus Payments *in 1,000 US$*	Other (1) *in 1,000 US$*	Share Awards Number of Shares	Share Awards Amount *in 1,000 US$*	Total *in 1,000 US$*
Dr. h.c. mult. Hansjörg Wyss, MD	Chairman - Executive	650	–	3,314	260	13,000	1,611	5,835
Mr. Charles Hedgepeth	Vice Chairman - Non-Executive	–	15	–	4	1,500	186	205
Mr. Robert Bland	Director - Non-Executive	–	31	–	–	1,200	149	180
Dr. Roland Brönnimann (2)	Director - Non-Executive	–	171	–	20	2,600	322	513
Dr. David Helfet	Director - Non-Executive	–	40	–	–	1,200	149	189
Mr. Amin Khoury	Director - Non-Executive	–	15	–	–	1,200	149	164
Dr. Allen Misher	Director - Non-Executive	–	48	–	–	1,200	149	197
Mr. André Mueller	Director - Non-Executive	–	25	–	–	1,200	149	174
Mr. Felix Pardo	Director - Non-Executive	–	31	–	–	1,200	149	180
Mr. Jobst Wagner	Director - Non-Executive	–	11	–	–	1,200	149	160
		650	**387**	**3,314**	**284**	**25,500**	**3,162**	**7,797**

(1) Includes perquisites and other compensation benefits paid during the year.

(2) Dr. Roland Brönnimann provides consulting services to the company in addition to his work as a Director.

In the aggregate, the compensation paid to the members of the Group Management Committee in fiscal year 2007 amounted to US$ 11.0 million.

Synthes, Inc. and Subsidiaries

Note to Directors and Shareholders

Holding company financial statements and footnotes are a Swiss Stock Exchange (SWX) 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 2007 annual report of Synthes, Inc.

A proposal by the Board of Directors for the dividends to be paid in 2008 follows on the next page.

Synthes, Inc. and Subsidiaries

Proposal by the Board of Directors for the Dividends

	in 1,000 US$
Beginning additional paid-in capital and retained earnings at December 31, 2006	3,252,116
Beginning retained earnings adjustment for adoption of FIN 48	(31,816)
Increase in additional paid-in capital in 2007	5,235
Profit for 2007	612,598
Dividends paid in 2007	(73,436)
Proposed dividends in 2008	(94,149)
Additional paid-in capital and retained earnings after proposed dividends	**3,670,548**

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, 2007 (118,699,793 registered shares), less treasury shares (564). 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 28, 2008 (each and all of the outstanding shares are entitled to an individual dividend of CHF 0.9000/US$ 0.7932 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, 2007 and 2006 consisted of 118,699,793 and 118,675,733 registered shares issued (118,699,229 and 118,666,769 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.

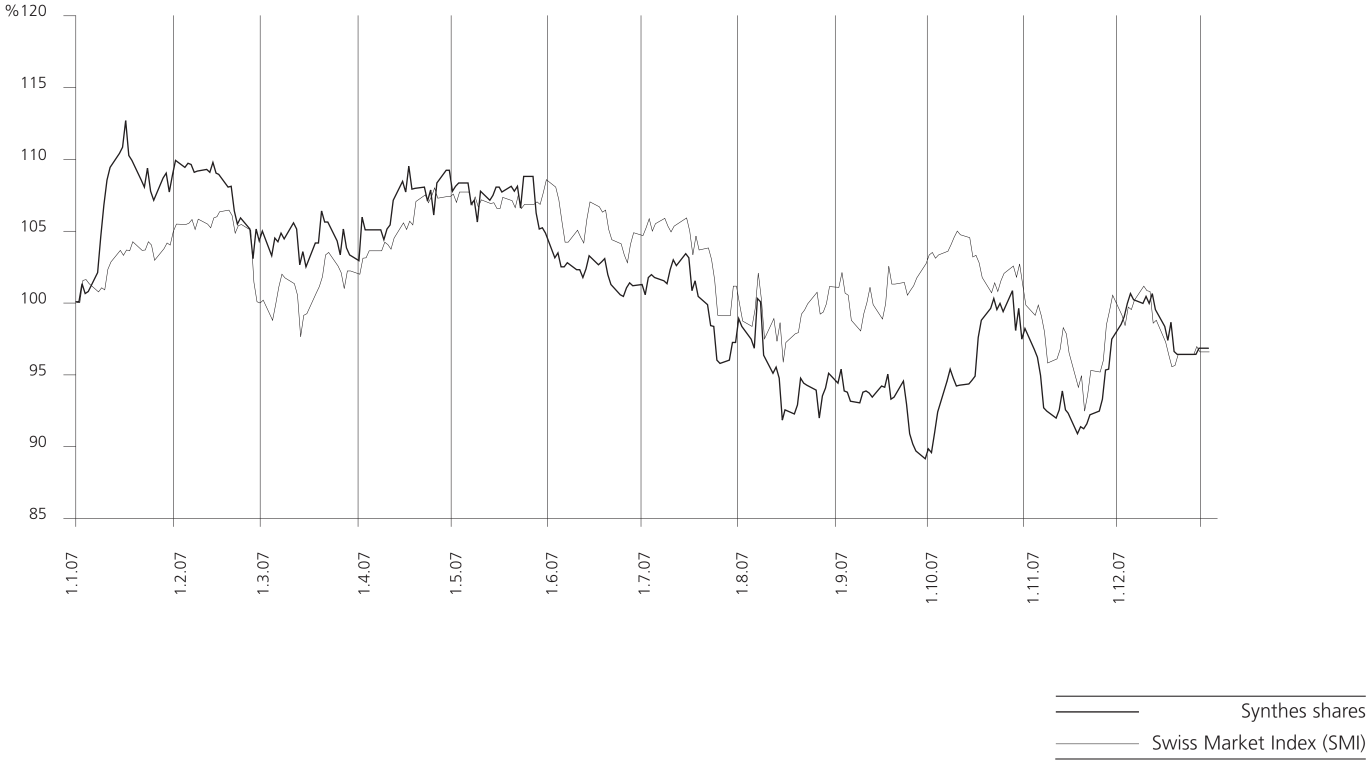
On April 4, 2000, at the first general meeting of the shareholders, an equity incentive plan was approved and adopted. This plan will allow for compensation of senior executives in accordance with international practices. Under the terms of the equity incentive plan, the company may issue up to 1,500,000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

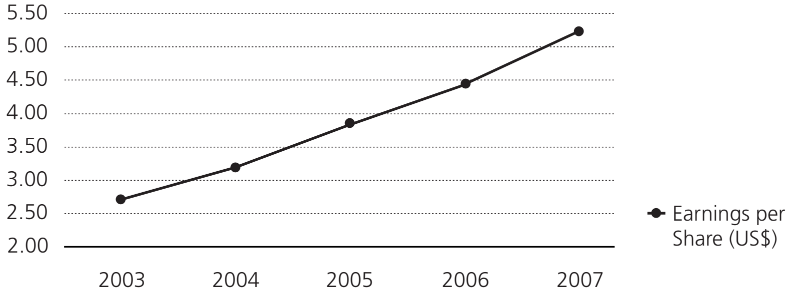
Development of share price

During the year 2007, the Synthes, Inc. share price decreased by 3.2% to CHF 140.6 per share. This performance compares to the development of the Swiss Market Index (SMI) which decreased by 3.4% during the same period. The share price saw its low on October 1, 2007 when it hit CHF 129.5 and reached its high of CHF 163.5 on January 17, 2007. The average share price for 2007 was CHF 146.7.

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



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



* *Pro forma: includes the former Mathys organization and Spine Solutions Inc. as if the acquisitions by Synthes had occured 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.

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