

WRIGHT MEDICAL GROUP INC

Form 10-Q

October 29, 2010

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2010

or

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

For the transition period from _____ to _____

Commission file number: 000-32883

WRIGHT MEDICAL GROUP, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware

(State or Other Jurisdiction
of Incorporation or Organization)

13-4088127

(IRS Employer
Identification Number)

**5677 Airline Road
Arlington, Tennessee**

(Address of Principal Executive Offices)

38002

(Zip Code)

(901) 867-9971

(Registrant's Telephone Number, Including Area Code)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller Reporting
Company

(Do not check if a smaller
reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of October 25, 2010, there were 39,190,314 shares of common stock outstanding.

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SAFE-HARBOR STATEMENT

This quarterly report contains forward-looking statements as defined under U.S. federal securities laws. These statements reflect management's current knowledge, assumptions, beliefs, estimates, and expectations and express management's current views of future performance, results, and trends and may be identified by their use of terms such as anticipate, believe, could, estimate, expect, intend, may, plan, predict, project, will, and other similar terms. Forward-looking statements are subject to a number of risks and uncertainties that could cause our actual results to materially differ from those described in the forward-looking statements. Readers should not place undue reliance on forward-looking statements. Such statements are made as of the date of this quarterly report, and we undertake no obligation to update such statements after this date.

Risks and uncertainties that could cause our actual results to materially differ from those described in forward-looking statements include those discussed in our filings with the Securities and Exchange Commission (including those described in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2009, under the heading,

Risk Factors and in Item 1A of Part II and elsewhere in this report), and the following:
the impact of our settlement of the federal investigation into our consulting arrangements with orthopaedic surgeons relating to our hip and knee products in the United States, including our compliance with the Deferred Prosecution Agreement through September 2011 and the Corporate Integrity Agreement through September 2015;

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demand for and market acceptance of our new and existing products;
recently enacted healthcare reform legislation and its future implementation, possible additional legislation, regulation and other governmental pressures in the United States or globally, which may affect pricing, reimbursement, taxation and rebate policies of government agencies and private payers or other elements of our business;
tax reform measures, tax authority examinations and associated tax risks and potential obligations;
our ability to identify business development and growth opportunities for existing or future products;
product quality or patient safety issues, leading to product recalls, withdrawals, launch delays, sanctions, seizures, litigation, or declining sales;
individual, group or class action alleging products liability claims, including an increase in the number of claims during any period;
future actions of the FDA or any other regulatory body or government authority that could delay, limit or suspend product development, manufacturing or sale or result in seizures, injunctions, monetary sanctions or criminal or civil liabilities;
our ability to enforce our patent rights or patents of third parties preventing or restricting the manufacture, sale or use of affected products or technology;
the impact of geographic and product mix on our sales;
retention of our sales representatives and independent distributors;
inventory reductions or fluctuations in buying patterns by wholesalers or distributors;
our ability to realize the anticipated benefits of restructuring initiatives; and
any impact of the commercial and credit environment on us and our customers and suppliers.

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WRIGHT MEDICAL GROUP, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)
(unaudited)

	September 30, 2010	December 31, 2009
Assets:		
Current assets:		
Cash and cash equivalents	\$ 123,170	\$ 84,409
Marketable securities	33,512	86,819
Accounts receivable, net	98,415	101,720
Inventories	167,058	163,535
Prepaid expenses	10,924	13,122
Deferred income taxes	35,008	34,824
Other current assets	5,204	6,175
Total current assets	473,291	490,604
Property, plant and equipment, net	151,860	139,708
Goodwill	53,716	53,860
Intangible assets, net	16,735	17,727
Marketable securities	34,124	
Deferred income taxes	6,169	5,248
Other assets	7,792	7,137
Total assets	\$ 743,687	\$ 714,284
Liabilities and Stockholders Equity:		
Current liabilities:		
Accounts payable	\$ 16,872	\$ 13,978
Accrued expenses and other current liabilities	61,841	54,643
Current portion of long-term obligations	305	336
Total current liabilities	79,018	68,957
Long-term debt and capital lease obligations	200,301	200,326
Deferred income taxes	153	157
Other liabilities	4,782	4,436
Total liabilities	\$ 284,254	\$ 273,876
Commitments and contingencies (Note 10)		
Stockholders equity:		

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Common stock, \$.01 par value, authorized: 100,000,000 shares; issued and outstanding: 39,189,950 shares at September 30, 2010 and 38,668,882 shares at December 31, 2009	379	374
Additional paid-in capital	387,009	376,647
Accumulated other comprehensive income	22,592	22,906
Retained earnings	49,453	40,481
Total stockholders' equity	459,433	440,408
Total liabilities and stockholders' equity	\$ 743,687	\$ 714,284

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

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WRIGHT MEDICAL GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)
(unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2010	2009	2010	2009
Net sales	\$ 121,708	\$ 117,742	\$ 380,686	\$ 357,580
Cost of sales ¹	37,989	35,880	118,064	110,646
Gross profit	83,719	81,862	262,622	246,934
Operating expenses:				
Selling, general and administrative ¹	64,877	63,703	209,089	196,133
Research and development ¹	8,779	8,537	28,398	26,460
Amortization of intangible assets	708	1,274	1,991	3,899
Restructuring charges (Note 9)	134	131	1,139	991
Total operating expenses	74,498	73,645	240,617	227,483
Operating income	9,221	8,217	22,005	19,451
Interest expense, net	1,532	1,435	4,550	3,974
Other expense (income), net	313	108	270	(358)
Income before income taxes	7,376	6,674	17,185	15,835
Provision for income taxes	2,726	2,522	8,213	5,939
Net income	\$ 4,650	\$ 4,152	\$ 8,972	\$ 9,896
Net income per share (Note 7):				
Basic	\$ 0.12	\$ 0.11	\$ 0.24	\$ 0.27
Diluted	\$ 0.12	\$ 0.11	\$ 0.24	\$ 0.26
Weighted-average number of shares outstanding-basic	37,935	37,431	37,748	37,331
Weighted-average number of shares outstanding-diluted	38,011	37,551	37,923	37,395

¹ These line items include the following amounts of non-cash, stock-based compensation

expense for the
periods
indicated:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2010	2009	2010	2009
Cost of sales	\$ 314	\$ 335	\$ 980	\$ 938
Selling, general and administrative	2,261	2,517	7,700	7,822
Research and development	492	480	1,500	1,440

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

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WRIGHT MEDICAL GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(unaudited)

	Nine Months Ended	
	September 30,	
	2010	2009
Operating activities:		
Net income	\$ 8,972	\$ 9,896
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	26,073	23,865
Stock-based compensation expense	10,180	10,200
Amortization of intangible assets	1,991	3,899
Amortization of deferred financing costs	777	738
Deferred income taxes	(3,470)	(2,709)
Excess tax benefit from stock-based compensation arrangements	(288)	(24)
Non-cash restructuring charges	246	
Other	1,170	(14)
Changes in assets and liabilities (net of acquisitions):		
Accounts receivable	3,384	(5,925)
Inventories	(2,736)	10,418
Prepaid expenses and other current assets	2,527	8,200
Accounts payable	2,949	(1,968)
Accrued expenses and other liabilities	8,221	(6,465)
Net cash provided by operating activities	59,996	50,111
Investing activities:		
Capital expenditures	(35,950)	(26,360)
Acquisitions of businesses	(2,072)	(5,973)
Purchase of intangible assets	(1,598)	(882)
Investment in held-to-maturity marketable securities	(4,674)	
Sales and maturities of available-for-sale marketable securities	104,049	65,192
Investment in available-for-sale marketable securities	(81,067)	(48,324)
Net cash used in investing activities	(21,312)	(16,347)
Financing activities:		
Issuance of common stock	461	231
Principal payments of bank and other financing	(968)	(107)
Financing under factoring agreements, net	5	(58)
Excess tax benefit from stock-based compensation arrangements	288	24
Net cash (used in) provided by financing activities	(214)	90
Effect of exchange rates on cash and cash equivalents	291	(485)
Net increase in cash and cash equivalents	38,761	33,369

Cash and cash equivalents, beginning of period	84,409	87,865
Cash and cash equivalents, end of period	\$ 123,170	\$ 121,234

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

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

1. Summary of Significant Accounting Policies

Basis of Presentation. The unaudited condensed consolidated interim financial statements of Wright Medical Group, Inc. have been prepared in accordance with accounting principles generally accepted in the United States (U.S.) for interim financial information and the instructions to Quarterly Report on Form 10-Q and Rule 10-01 of Regulation S-X. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the U.S. have been condensed or omitted pursuant to these rules and regulations. Accordingly, these unaudited condensed consolidated interim financial statements should be read in conjunction with our consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2009, as filed with the U.S. Securities and Exchange Commission (SEC). In the opinion of management, these unaudited condensed consolidated interim financial statements reflect all adjustments necessary for a fair presentation of our interim financial results. All such adjustments are of a normal and recurring nature. The results of operations for any interim period are not indicative of results for the full fiscal year. The accompanying unaudited condensed consolidated interim financial statements include our accounts and those of our wholly-owned domestic and international subsidiaries. Intercompany accounts and transactions have been eliminated in consolidation.

Marketable Securities. We have historically invested in treasury bills, government and agency bonds, and certificates of deposit with maturity dates of less than 12 months. Beginning in the second quarter of 2010, we also invested in marketable securities with maturity dates greater than 12 months. Our investments in these marketable securities are classified as available-for-sale securities in accordance with Financial Accounting Standards Board (FASB) Accounting Standard Codification (ASC) Topic 320, *Investments – Debt and Equity Securities*. These securities are carried at their fair value, and all unrealized gains and losses are recorded within other comprehensive income. In the third quarter of 2010, we invested in a bank deposit with a maturity date of 12 months. This investment, which is classified as held-to-maturity, is carried at its amortized cost. Marketable securities are classified as short-term for those expected to mature or be sold within 12 months and the remaining portion is classified as long-term. The cost of investment securities sold is determined by the specific identification method. The following tables present a summary of our marketable securities (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
At September 30, 2010				
Available-for-sale marketable securities				
Municipal debt securities	\$ 903	\$ 3	\$	\$ 906
U.S. agency debt securities	41,356	28	(2)	41,382
Certificates of deposits	1,363			1,363
Corporate debt securities	3,199	13		3,212
U.S. government debt securities	16,034	26		16,060
Total available-for-sale marketable securities	\$ 62,855	\$ 70	\$ (2)	\$ 62,923
Held-to-maturity time deposits	\$ 4,713	\$	\$	\$ 4,713
Total marketable securities	\$ 67,568	\$ 70	\$ (2)	\$ 67,636

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	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
At December 31, 2009				
Available-for-sale marketable securities				
U.S. agency debt securities	\$ 69,819	\$ 11	\$ (50)	\$ 69,780
Certificates of deposits	1,435		(5)	1,430
U.S. government debt securities	15,604	10	(5)	15,609
Total available-for-sale marketable securities	\$ 86,858	\$ 21	\$ (60)	\$ 86,819
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WRIGHT MEDICAL GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(UNAUDITED)

The maturities of available-for-sale and held-to-maturity debt securities at September 30, 2010 are as follows:

	Available-for-Sale		Held-to-maturity	
	Cost Basis	Fair Value	Cost Basis	Fair Value
Due in one year or less	\$ 28,786	\$ 28,799	\$ 4,713	\$ 4,713
Due after one year through two years	26,569	26,620		
Due after two years	7,500	7,504		
	\$ 62,855	\$ 62,923	\$ 4,713	\$ 4,713

Fair Value of Financial Instruments. The carrying values of cash and cash equivalents, accounts receivable, and accounts payable approximate the fair values of these financial instruments as of September 30, 2010 and December 31, 2009 due to their short maturities.

Effective January 1, 2008, we adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* (SFAS 157), for financial assets and liabilities measured at fair value on a recurring basis. Effective January 1, 2009, we adopted the provisions of SFAS 157 for nonfinancial assets and liabilities measured at fair value on a recurring basis. SFAS 157 applies to all financial and nonfinancial assets and liabilities that are being measured and reported on a fair value basis, establishes a framework for measuring the fair value of assets and liabilities, and expands disclosures about fair value measurements. The adoption of SFAS 157 had no impact to our condensed consolidated interim financial statements. Effective July 1, 2009, this standard was incorporated into FASB ASC Topic 820, *Fair Value Measurements and Disclosures* (FASB ASC 820). FASB ASC 820-10-50 requires fair value measurements be classified and disclosed in one of the following three categories:

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

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

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

As of September 30, 2010 and December 31, 2009, we had current marketable securities totaling \$33.5 million and \$86.8 million, respectively, consisting of investments in treasury bills, government and agency bonds, and certificates of deposits, all of which are valued at fair value using a market approach. In addition, we had noncurrent marketable securities totaling \$34.1 million as of September 30, 2010, consisting of investments in government, agency, and corporate bonds, all of which are valued at fair value using a market approach.

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

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WRIGHT MEDICAL GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(UNAUDITED)

	Total	Quoted Prices in Active Markets (Level 1)	Prices with Other Observable Inputs (Level 2)	Prices with Unobservable Inputs (Level 3)
At September 30, 2010				
Assets				
Cash and cash equivalents	\$ 123,170	\$ 123,170	\$	\$
Available-for-sale marketable securities				
Municipal debt securities	\$ 906	\$ 906	\$	\$
U.S. agency debt securities	41,382	41,382		
Certificates of deposits	1,363		1,363	
Corporate debt securities	3,212	3,212		
U.S. government debt securities	16,060	16,060		
Total available-for-sale marketable securities	62,923	61,560	1,363	
Held-to-maturity time deposits	4,713		4,713	
	\$ 190,806	\$ 184,730	\$ 6,076	\$
Liabilities				
Convertible Senior Notes	178,000	178,000		
	\$ 178,000	\$ 178,000	\$	\$
	Total	Quoted Prices in Active Markets (Level 1)	Prices with Other Observable Inputs (Level 2)	Prices with Unobservable Inputs (Level 3)
At December 31, 2009				
Assets				
Cash and cash equivalents	\$ 84,409	\$ 84,409	\$	\$
Available-for-sale marketable securities				
U.S. agency debt securities	\$ 69,780	\$ 69,780	\$	\$
Certificates of deposits	1,430		1,430	

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U.S. government debt securities	15,609	15,609		
	86,819	85,389	1,430	
	\$ 171,228	\$ 169,798	\$ 1,430	\$
Liabilities				
Convertible Senior Notes	176,000	176,000		
	\$ 176,000	\$ 176,000	\$	\$

2. Inventories

Inventories consist of the following (in thousands):

	September 30, 2010	December 31, 2009
Raw materials	\$ 8,354	\$ 8,606
Work-in-process	25,543	23,766
Finished goods	133,161	131,163
	\$ 167,058	\$ 163,535

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WRIGHT MEDICAL GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(UNAUDITED)

3. Property, Plant and Equipment, Net

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

	September 30, 2010	December 31, 2009
Property, plant and equipment, at cost	\$ 314,741	\$ 286,086
Less: Accumulated depreciation	(162,881)	(146,378)
	\$ 151,860	\$ 139,708

4. Long-Term Debt and Capital Lease Obligations

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

	September 30, 2010	December 31, 2009
Capital lease obligations	\$ 606	\$ 662
Convertible senior notes	200,000	200,000
	200,606	200,662
Less: current portion	(305)	(336)
	\$ 200,301	\$ 200,326

In November 2007, we issued \$200 million of Convertible Senior Notes due 2014. The notes will mature on December 1, 2014. The notes pay interest semiannually at an annual rate of 2.625% and are convertible into shares of our common stock at an initial conversion rate of 30.6279 shares per \$1,000 principal amount of the notes, which represents a conversion price of \$32.65 per share. The holder of the notes may convert at any time on or prior to the close of business on the business day immediately preceding the maturity date of notes. Beginning on December 6, 2011, we may redeem the notes, in whole or in part, at a redemption price equal to 100% of the principal amount of the notes, plus accrued and unpaid interest, if the closing price of our common stock has exceeded 140% of the conversion price for at least 20 days during any consecutive 30-day trading period. Additionally, if we experience a fundamental change event, as defined in the note agreement, the holders may require us to purchase for cash all or a portion of the notes for 100% of the principal amount of the notes, plus accrued and unpaid interest. If upon a fundamental change event, a holder elects to convert its notes, we may, under certain circumstances, increase the conversion rate for the notes surrendered. The notes are unsecured obligations and are subordinate to all existing and future secured debt, our revolving credit facility, and all liabilities of our subsidiaries.

On June 30, 2010, we renewed our revolving credit facility. The revolving credit facility has availability of \$100 million, which can be increased by up to an additional \$50 million at our request and subject to the agreement of the lenders. We currently have no borrowings outstanding under the credit facility. Borrowings under the credit facility will bear interest at the sum of a base rate or Eurodollar rate plus an applicable margin that ranges from 0.25% to 2.50% depending on the type of loan and our consolidated leverage ratio, with a current annual base rate of 3.25% and a Eurodollar rate of 0.46% (6 month rate). The term of the credit facility extends through June 30, 2014.

5. Goodwill and Intangible Assets

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Changes in the carrying amount of goodwill occurring during the nine months ended September 30, 2010, are as follows (in thousands):

Goodwill at December 31, 2009	\$ 53,860
Goodwill from contingent consideration associated with acquisitions prior to 2010	258
Foreign currency translation	(402)
Goodwill at September 30, 2010	\$ 53,716

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WRIGHT MEDICAL GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(UNAUDITED)

During the nine months ended September 30, 2010, we made payments for contingent consideration of \$237,000 associated with the acquisition of the assets of Creative Medical Designs, Inc. and Rayhack LLC, which was accrued as of December 31, 2009, and \$1.8 million associated with the acquisition of the assets of Inbone Technologies, Inc., completed in 2008, of which \$1.7 million was accrued as of December 31, 2009.

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

	September 30, 2010		December 31, 2009	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Distribution channels	\$ 21,249	\$ 21,087	\$ 22,207	\$ 22,025
Completed technology	12,645	5,922	12,537	5,213
Licenses	8,006	4,327	7,245	3,777
Customer relationships	3,750	992	3,750	720
Trademarks	2,753	707	2,733	570
Other	2,824	1,457	2,620	1,060
	51,227	\$ 34,492	51,092	\$ 33,365
Less: Accumulated amortization	(34,492)		(33,365)	
Intangible assets, net	\$ 16,735		\$ 17,727	

Based on the intangible assets held at September 30, 2010, we expect to amortize approximately \$2.7 million for the full year of 2010, \$2.5 million in 2011, \$2.2 million in 2012, \$1.9 million in 2013, and \$1.7 million in 2014.

6. Stock-Based Compensation

Amounts recognized within the condensed consolidated financial statements are as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Total cost of share-based payment plans	\$ 3,121	\$ 3,399	\$ 10,216	\$ 10,314
Amounts capitalized as inventory and intangible assets	(371)	(402)	(1,025)	(1,052)
Amortization of capitalized amounts	317	335	989	938
Charged against income before income taxes	3,067	3,332	10,180	10,200
Amount of related income tax benefit	(1,116)	(968)	(3,266)	(3,005)
Impact to net income	\$ 1,951	\$ 2,364	\$ 6,914	\$ 7,195
Impact to basic earnings per share	\$ 0.05	\$ 0.06	\$ 0.18	\$ 0.19
Impact to diluted earnings per share	\$ 0.05	\$ 0.06	\$ 0.18	\$ 0.19

In the nine-month period ended September 30, 2010, we granted approximately 296,000 stock options, 504,000 non-vested shares of common stock, and 88,000 restricted stock units at weighted-average fair values of \$6.98, \$18.35 and \$18.31, respectively, which will be recognized on a straight line basis over the requisite service period of four

years. Of the 296,000 stock options granted in the nine-month period ended September 30, 2010, 65,000 were granted as an inducement grant. As of September 30, 2010, we had approximately 4.0 million stock options (of which approximately 3.1 million were exercisable), 1.3 million non-vested shares of common stock, 18,000 stock-settled phantom stock units, and 119,000 restricted stock units outstanding.

As of September 30, 2010, we had \$23.7 million of total unrecognized compensation cost related to unvested stock-based compensation arrangements granted to employees, which is expected to be recognized over a weighted-average period of 2.6 years.

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WRIGHT MEDICAL GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(UNAUDITED)

7. Earnings Per Share

FASB ASC Topic 260, *Earnings Per Share*, requires the presentation of basic and diluted earnings per share. Basic earnings per share is calculated based on the weighted-average number of shares of common stock outstanding during the period. Diluted earnings per share is calculated to include any dilutive effect of our common stock equivalents. Our common stock equivalents consist of stock options, non-vested shares of common stock, stock-settled phantom stock units, restricted stock units, and convertible debt. The dilutive effect of the stock options, non-vested shares of common stock, stock-settled phantom stock units, and restricted stock units is calculated using the treasury-stock method. The dilutive effect of convertible debt is calculated by applying the if-converted method. This assumes an add-back of interest, net of income taxes, to net income as if the securities were converted at the beginning of the period. During the three-month and nine-month periods ending September 30, 2010 and 2009, the convertible debt had an anti-dilutive effect on earnings per share and we therefore excluded it from the dilutive shares calculation. The weighted-average number of shares outstanding for basic and diluted earnings per share is as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2010	2009	2010	2009
Weighted-average number of shares outstanding, basic	37,935	37,431	37,748	37,331
Common stock equivalents	76	120	175	64
Weighted-average number of shares outstanding, diluted	38,011	37,551	37,923	37,395

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2010	2009	2010	2009
Stock options	3,943	4,120	3,856	4,118
Non-vested shares, restricted stock units, and stock-settled phantom stock units	626	530	687	1,231
Convertible debt	6,126	6,126	6,126	6,126

8. Other Comprehensive Income

The difference between our net income and our comprehensive income is attributable to foreign currency translation, unrealized gains and losses on our available-for-sale marketable securities, and adjustments related to our minimum pension liability in Japan. The following table provides a reconciliation of net income to comprehensive income (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2010	2009	2010	2009
Net income	\$ 4,650	\$ 4,152	\$ 8,972	\$ 9,896
Changes in foreign currency translation	6,728	2,449	(434)	3,251
Unrealized gain (loss) on marketable securities	16	(39)	107	(394)
Minimum pension liability adjustment	5	4	13	12

Comprehensive income	\$ 11,399	\$ 6,566	\$ 8,658	\$ 12,765
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WRIGHT MEDICAL GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(UNAUDITED)

9. RestructuringToulon, France

In June 2007, we announced plans to close our manufacturing, distribution, and administrative facility located in Toulon, France. The facility's closure affected approximately 130 Toulon-based employees. The majority of our restructuring activities were complete by the end of 2007, with production now conducted in our existing manufacturing facility in Arlington, Tennessee, and European distribution activities being carried out from our European headquarters in Amsterdam, the Netherlands.

Management estimates that the pre-tax restructuring charges will total approximately \$28 million to \$30 million. These charges consist of the following estimates:

\$14 million for severance and other termination benefits;

\$3 million of non-cash asset impairments of property, plant and equipment;

\$2 million of inventory write-offs and manufacturing period costs;

\$3 million to \$4 million of external legal and professional fees; and

\$6 million to \$7 million of other cash and non-cash charges (including employee litigation).

Charges associated with the restructuring are presented in the following table. All of the following amounts were recognized within Restructuring charges in our consolidated statement of operations, with the exception of the inventory write-offs and manufacturing period costs, which were recognized within Cost of sales restructuring.

(in thousands)	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2010	Cumulative Charges as of September 30, 2010
Severance and other termination benefits	\$ 2	\$ 26	\$ 13,576
Employee litigation accrual	(5)	103	5,151
Asset impairment charges			3,093
Inventory write-offs and manufacturing period costs			2,139
Legal/professional fees	137	339	3,356
Other			194
Total restructuring charges	\$ 134	\$ 468	\$ 27,509

Activity in the restructuring liability for the nine months ended September 30, 2010 is presented in the following table (in thousands):

Beginning balance as of December 31, 2009	\$ 4,964
Charges:	
Severance and other termination benefits	26
Employee litigation accrual	103

Legal/professional fees	339
Total accruals	468
Payments:	
Severance and other termination benefits	(16)
Employee litigation accrual	(1,098)
Legal/professional fees	(404)
Total payments	(1,518)
Changes in foreign currency translation	(358)
Restructuring liability at September 30, 2010	\$ 3,556

In connection with the closure of our Toulon, France facility, 103 of our former employees have filed claims to challenge the economic justification for their dismissal. To date, judgments have been rendered for 86 of those claims, the substantial majority of which were unfavorable to us and for which we have been required to pay a portion of the judgment, totaling approximately \$1.1 million. An appellate hearing related to these judgments was held during the three months ended September 30, 2010, however a ruling has not been issued. Management has

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WRIGHT MEDICAL GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(UNAUDITED)

estimated the remaining probable liability upon the ultimate resolution of these 103 claims to be \$3.3 million, and has therefore recorded this amount as a liability within Accrued expenses and other current liabilities in our condensed consolidated balance sheet as of September 30, 2010.

Creteil, France

In October 2009, we announced plans to close our distribution and finance support office in Creteil, France, in order to migrate all relevant French distribution and support functions into our European organization based out of our European headquarters in Amsterdam, the Netherlands.

As of September 30, 2010, we have concluded our restructuring efforts in Creteil, incurring a total of \$2.8 million of charges, however certain liabilities remain to be paid. No charges were incurred in the three months ended September 30, 2010.

Charges associated with the restructuring are presented in the following table. All of the following amounts were recognized within Restructuring charges in our consolidated statement of operations.

(in thousands)	Nine Months Ended September 30, 2010	Cumulative Charges as of September 30, 2010
Severance and other termination benefits	\$ 52	\$ 876
Asset disposals	121	121
Legal/professional fees	66	328
Contract termination costs	133	1,128
Other	299	299
Total restructuring charges	\$ 671	\$ 2,752

Activity in the restructuring liability for the nine months ended September 30, 2010 is presented in the following table (in thousands):

Beginning balance as of December 31, 2009	\$ 1,817
Charges:	
Severance and other termination benefits	52
Contract termination costs	6
Legal/professional fees	66
Other	299
Total accruals	423
Payments:	
Severance and other termination benefits	(647)
Contract termination costs	(927)
Legal/professional fees	(197)
Other	(311)

Total payments	(2,082)
Changes in foreign currency translation	(70)
Restructuring liability at September 30, 2010	\$ 88

10. Commitments and Contingencies

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

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WRIGHT MEDICAL GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(UNAUDITED)

On September 29, 2010, our wholly-owned subsidiary, Wright Medical Technology, Inc. (WMT) entered into a 12-month Deferred Prosecution Agreement (DPA) with the USAO and a Civil Settlement Agreement (CSA) with the United States. Under the DPA, the USAO agrees not to prosecute WMT in connection with the matter if WMT satisfies its obligations during the 12 month term of the DPA. Pursuant to the CSA, WMT settled civil and administrative claims relating to the matter for a payment of \$7.9 million without any admission by WMT. In conjunction with the CSA, WMT also entered into a five year Corporate Integrity Agreement (CIA) with the Office of the Inspector General of the United States Department of Health and Human Services. Pursuant to the DPA, an independent monitor will review and evaluate WMT's compliance with its obligations under the DPA. Together, these agreements resolve the investigation commenced by the USAO in December 2007. The USAO specifically acknowledges in the DPA that it does not allege that WMT's conduct adversely affected patient health or patient care. We previously accrued a provision of approximately \$8 million for an anticipated settlement of this investigation; therefore, we did not have a material impact to our consolidated financial position or results of operations during the three months ended September 30, 2010 related to these settlements.

As of September 30, 2010, the trade receivable balance due from our stocking distributor in Turkey was \$9.4 million, of which a significant portion is past due. We have a reserve of \$5.6 million against this balance as of June 30, 2010. It is possible that the future realization of this accounts receivable balance could be more or less than the remaining unreserved balance of \$3.8 million.

In addition to the stocking distributor in Turkey, our next ten largest international stocking distributors have net trade receivable balances totaling approximately \$17 million as of September 30, 2010. No allowance has been provided on these balances as management believes it is probable that the balances will be fully collected. However, it is at least reasonably possible that changes in global economic conditions and/or local operating and economic conditions in the regions these distributors operate, or other factors, could affect the future realization of these accounts receivable balances.

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

Table of Contents**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.****General**

The following management's discussion and analysis of financial condition and results of operations describes the principal factors affecting the results of our operations, financial condition, and changes in financial condition for the three- and nine-month periods ended September 30, 2010. This discussion should be read in conjunction with the accompanying unaudited financial statements, our Annual Report on Form 10-K for the year ended December 31, 2009, which includes additional information about our critical accounting policies and practices and risk factors, and Item 1A of Part II of this report, which updates those risk factors.

Executive Overview

Company Description. We are a global orthopaedic medical device company specializing in the design, manufacture, and marketing of devices and biologic products for extremity, hip, and knee repair and reconstruction. Extremity hardware includes implants and other devices to replace or reconstruct injured or diseased joints and bones of the foot, ankle, hand, wrist, elbow, and shoulder, which we generally refer to as either foot and ankle or upper extremity products. We are a leading provider of surgical solutions for the foot and ankle market. Reconstructive devices are used to replace or repair knee, hip, and other joints and bones that have deteriorated or been damaged through disease or injury. Biologics are used to repair or replace damaged or diseased bone, to stimulate bone growth and to provide other biological solutions for surgeons and their patients. Within these markets, we focus on the higher-growth sectors of the orthopaedic industry, such as the foot and ankle market, as well as on the integration of our biologic products into reconstructive procedures and other orthopaedic applications. Our extensive foot and ankle product portfolio, our over 150 specialized foot and ankle sales representatives, and our increasing level of training of foot and ankle surgeons has resulted in our being a recognized leader in the foot and ankle market. We have been in business for over 60 years and have built a well-known and respected brand name and strong relationships with orthopaedic surgeons and surgical podiatrists.

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

Significant Quarterly Business Developments. Net sales increased 3% in the third quarter of 2010 to \$121.7 million, compared to net sales of \$117.7 million in the third quarter of 2009. In the third quarter of 2010, we recorded net income of \$4.7 million, compared to net income of \$4.2 million for the third quarter of 2009, primarily as a result of decreased expenses relating to ongoing governmental inquiries, decreased amortization expense, and decreased levels of non-cash, stock based compensation expense.

Our third quarter domestic sales increased 1% in 2010, primarily due to 13% growth within our extremity line. Our domestic extremities growth is primarily attributable to higher sales volume of our foot and ankle products, in particular our INBONE products, our ORTHOLOC Polyaxial Locked Plating System, launched in September 2009, our DARCO® plating systems, and our VALOR® Hindfoot Fusion Nail System launched in June 2010. Domestic sales of our biologic products increased by 2% in the third quarter of 2010 as compared to the same period in 2009. Our domestic knee sales and domestic hip sales decreased by 5% and 9%, respectively, in the third quarter of 2010 as compared to the same period in 2009 due to lower levels of unit sales volume as well as lower pricing, both of which are impacted by market conditions throughout the industry.

Our international sales increased 7% to \$47.1 million in the third quarter of 2010, compared to \$44.0 million in the third quarter of 2009. This increase in sales in the third quarter of 2010 compared to 2009 is primarily the result of increased sales in Japan, Latin America and Australia.

During the three months ended September 30, 2010, we reached a settlement agreement with the United States for a payment \$7.9 million without any admission by us. In addition, pursuant to a Deferred Prosecution Agreement, an independent monitor will review and evaluate our compliance with our obligations under this agreement for a period of 12 months.

Opportunities and Challenges. Our results of operations can be substantially affected not only by global economic conditions, but also by local operating and economic conditions, which can vary substantially by market.

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Unfavorable conditions can depress sales in a given market and may result in actions that adversely affect our margins, constrain our operating flexibility, or result in charges which are unusual or non-recurring. The global economy negatively impacted industry growth rates in both domestic and international markets beginning in 2009, and we are unable to predict when these markets will return to historical rates of growth, if ever.

In our domestic markets, we expect that an expansion of our focused foot and ankle sales force and new product offerings will continue to favorably impact our extremities and biologics businesses in the remainder of 2010. We believe that our domestic hip and knee business will be unfavorably impacted by market conditions during the remainder of the year.

During 2010, we expect positive impact from our increased presence in Australia and the annualization of the lower levels of revenues from our international stocking distributor business. Given these expectations, we anticipate moderate levels of sales growth in our international business for the remainder of 2010.

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

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

On September 29, 2010, our wholly-owned subsidiary, Wright Medical Technology, Inc. (WMT) entered into a 12-month Deferred Prosecution Agreement (DPA) with the USAO and a Civil Settlement Agreement (CSA) with the United States. Under the DPA, the USAO agrees not to prosecute WMT in connection with the matter if WMT satisfies its obligations during the 12 month term of the DPA. Pursuant to the CSA, WMT settled civil and administrative claims relating to the matter for a payment of \$7.9 million without any admission by WMT. In conjunction with the CSA, WMT also entered into a five year Corporate Integrity Agreement (CIA) with the Office of the Inspector General of the United States Department of Health and Human Services. Pursuant to the DPA, an independent monitor will review and evaluate WMT's compliance with its obligations under the DPA. Together, these agreements resolve the investigation commenced by the USAO in December 2007. The USAO specifically acknowledges in the DPA that it does not allege that WMT's conduct adversely affected patient health or patient care. We previously accrued a provision of approximately \$8 million for an anticipated settlement of this investigation; therefore, we did not have a material impact to our consolidated financial position or results of operations during the three months ended September 30, 2010 related to these settlements. The DPA and CIA impose certain obligations on the Company to maintain compliance with U.S. healthcare regulatory laws. Our failure to do so could expose us to significant liability including, but not limited to, extension of the term of the DPA by up to 6 months, exclusion from federal healthcare program participation, including Medicaid and Medicare, civil and criminal fines or penalties, and additional litigation cost and expense. Our obligations under the DPA expire as of September 29, 2011 while our obligations under our CIA expire as of September 29, 2014.

In March 2010, comprehensive health care reform legislation in the form of the Patient Protection and Affordable Health Care Act and the Health Care and Education Reconciliation Act was enacted. Among other initiatives, these bills impose a 2.3% excise tax on domestic sales of medical devices after December 31, 2012.

A detailed discussion of these risks and other factors is provided in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2009, and Item 1A of Part II and elsewhere in this report.

Table of Contents**Results of Operations****Comparison of three months ended September 30, 2010 to three months ended September 30, 2009**

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

	Three Months Ended September 30, 2010		Three Months Ended September 30, 2009	
	Amount	% of Sales	Amount	% of Sales
Net sales	\$ 121,708	100.0%	\$ 117,742	100.0%
Cost of sales ¹	37,989	31.2%	35,880	30.5%
Gross profit	83,719	68.8%	81,862	69.5%
Operating expenses:				
Selling, general and administrative ¹	64,877	53.3%	63,703	54.1%
Research and development ¹	8,779	7.2%	8,537	7.3%
Amortization of intangible assets	708	0.6%	1,274	1.1%
Restructuring charges	134	0.1%	131	0.1%
Total operating expenses	74,498	61.2%	73,645	62.5%
Operating income	9,221	7.6%	8,217	7.0%
Interest expense, net	1,532	1.3%	1,435	1.2%
Other income, net	313	0.3%	108	0.1%
Income before income taxes	7,376	6.1%	6,674	5.7%
Provision for income taxes	2,726	2.2%	2,522	2.1%
Net income	\$ 4,650	3.8%	\$ 4,152	3.5%

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

	Three Months Ended September 30,		% of Sales	% of Sales
	2010	2009		
Cost of sales	\$ 314	\$ 335	0.3%	0.3%
Selling, general and administrative	2,261	2,517	1.9%	2.1%

Research and development	492	0.4%	480	0.4%
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The following table sets forth our net sales by product line for the periods indicated (in thousands) and the percentage of year-over-year change:

	Three Months Ended September 30,		
	2010	2009	% Change
Hip products	\$ 39,956	\$ 40,055	(0.2%)
Knee products	29,549	30,114	(1.9%)
Extremity products	30,125	25,546	17.9%
Biologics products	19,666	19,437	1.2%
Other	2,412	2,590	(6.9%)
 Total net sales	 \$ 121,708	 \$ 117,742	 3.4%

The following graphs illustrate our product line net sales as a percentage of total net sales for the three months ended September