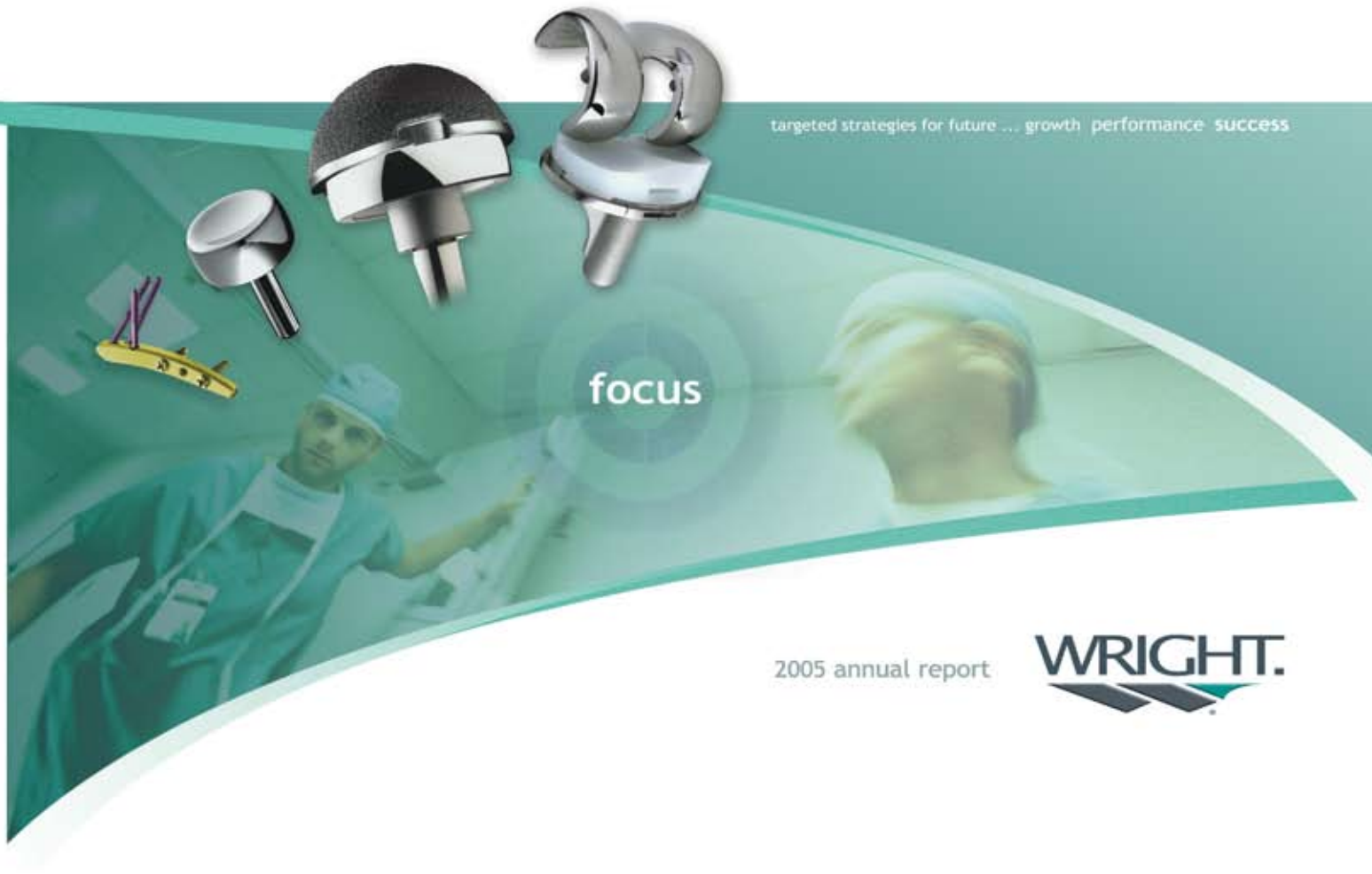


targeted strategies for future ... growth performance **success**

# focus

2005 annual report

WRIGHT.

# focus on wright.

**biologic solutions**

bone repair
infection treatment
soft-tissue repair
anti-adhesion

$900M market
21% market growth
1% sales growth

**hip solutions**

advanced bearings
bone conserving
modular necks
MIS techniques

$4B market
11% market growth
10% sales growth

**extremity solutions**

foot and ankle
hand and wrist
upper extremity

$400M market
13% market growth
14% sales growth

**knee solutions**

anatomic kinematics
MIS techniques
limb salvage

$4.5B market
11% market growth
8% sales growth

| | | |
|---|---|---|
| **biologic solutions** | 20.9% | total revenue |
| **extremity solutions** | 12.2% | total revenue |
| **hip solutions** | 33.3% | total revenue |
| **knee solutions** | 29.4% | total revenue |

Wright Medical Group, Inc. is a leading global orthopaedic medical device company specializing in the design, manufacture, and marketing of reconstructive joint devices and biologic products.

Wright's product offerings include large joint implants for the hip and knee; extremity implants for the hand, elbow, shoulder, foot and ankle; and both synthetic and tissue-based graft substitute materials. The Company participates in the $21 billion worldwide orthopaedic market and distributes its products through a combination of direct sales personnel and a network of independent distributors and sales personnel.

Headquartered in Arlington, Tennessee, the Company has been in business for more than 50 years and retains approximately 1,000 employees who provide outstanding service and innovative products throughout the world.

Wright's common stock is traded on the Nasdaq National Market under the symbol "WMGI."

# focus on financials.

dollars are in thousands

| | 2001[1] | 2002[2] | 2003[3] | 2004[4] | 2005[5] |
|---|---|---|---|---|---|
| net sales | $172,291 | $200,873 | $248,932 | $297,539 | $319,137 |
| gross profit, as reported | $121,570 | $145,257 | $181,117 | $213,356 | $227,397 |
| as a percentage of net sales | 70.3% | 72.3% | 72.8% | 71.7% | 71.3% |
| gross profit, as adjusted | $121,570 | $145,257 | $181,117 | $215,875 | $228,894 |
| as a percentage of net sales | 70.3% | 72.3% | 72.8% | 72.6% | 71.7% |
| operating income, as reported | $8,561 | $26,555 | $27,166 | $38,413 | $33,481 |
| as a percentage of net sales | 5.0% | 13.2% | 10.9% | 12.9% | 10.5% |
| operating income, as adjusted | $8,561 | $21,555 | $31,724 | $42,095 | $39,054 |
| as a percentage of sales | 5.0% | 10.7% | 12.7% | 14.1% | 12.2% |
| net income (loss), as reported | $(1,507) | $25,060 | $17,397 | $24,022 | $21,065 |
| as a percentage of sales | (0.9%) | 12.5% | 7.0% | 8.1% | 6.6% |
| net income (loss), as adjusted | $(1,507) | $16,398 | $20,216 | $26,451 | $24,892 |
| as a percentage of sales | (0.9%) | 8.2% | 8.1% | 8.9% | 7.8% |
| diluted earnings (loss) per share, proforma[6] | | | | | |
| as reported | $(0.06) | $0.75 | $0.50 | $ 0.68 | $ 0.60 |
| as adjusted | (0.60) | 0.49 | 0.58 | $ 0.75 | $ 0.71 |
| total assets | $193,719 | $276,370 | $322,103 | $361,158 | $371,810 |
| total long-term obligations | $19,804 | $16,586 | $11,096 | $5,952 | $1,728 |

(1) In accordance with the provisions of SFAS No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections," the Company's $1.6 million loss on early retirement of debt in 2001 does not meet the criteria to be classified as extraordinary. Consequently, this amount has been reclassified and included within the Company's results from operations.

(2) 2002 adjusted results presented above exclude a $4.2 million ($2.6 million after tax effect) arbitration settlement award, an $800,000 ($593,000 after tax effect) royalty resolution, and a $5.5 million income tax benefit.

(3) 2003 adjusted results presented above exclude $4.6 million ($2.8 million after tax effect) of acquired in-process research and development costs.

(4) 2004 adjusted results presented above exclude $2.4 million ($1.6 million after tax effect) of costs incurred to write down certain foot and ankle inventory to its net realizable value and $510,000 ($338,000 after tax effect) of accelerated depreciation on surgical instrumentation related to this inventory as a result of the transition of this product line to our CHARLOTTE™ Foot and Ankle System and $791,000 ($511,000 after tax effect) of costs associated with the voluntary market withdrawal of certain CONSERVE® hip components.

(5) 2005 adjusted results presented above exclude $1.7 million ($1.2 million after tax effect) of severance costs associated with management changes in our U.S. and European operations, $1.6 million ($1.1 million after tax effect) of costs incurred to write down inventory and surgical instruments to their net realizable value due to the termination of an agreement to distribute certain third party spinal products in Europe, $1.5 million ($1.0 million after tax effect) of costs related to a European distributor transition and the associated legal dispute, and $694,000 ($476,000 after tax effect) to write down a long-lived asset to its fair value.

(6) The computation of proforma diluted earnings (loss) per share for 2001 includes shares issuable upon the conversion of convertible preferred stock and related dividends as if such stock was converted on January 1, 2001. The computation of proforma diluted earnings per share for 2005, 2004, 2003 and 2002 do not differ from actual per share results.


## We are Wright and we are focused in 2006.

## Focused on reality-based performance - things we excel at, such as niche-based, high-margin solutions for the orthopaedic market.

We Invite You To Read More

**To Our Stockholders, Customers and Employees:**

2005 proved to be a very challenging year for Wright Medical Group, Inc., resulting in overall financial performance that fell short of both our expectations and those of our investors. For the first time since becoming a public company in 2001, Wright experienced a decrease in sales momentum gains from previous years, as well as a decline in earnings per share. While these overall results are very disappointing, there is most certainly cause for optimism about the future due to our expectations for the innovative orthopaedic products residing within each of our four major product lines. Wright's global product portfolio is broad and well-balanced, consisting of differentiated reconstructive total joint hip and knee implants, technologically advanced upper and lower extremity products and a full complement of bone repair and soft tissue products within our biologics business. Throughout the year, new product innovations within each of these business segments were launched in our various global markets. These new product introductions took place in a favorable worldwide orthopaedic market that is estimated to reach approximately $23 billion dollars by the end of 2006. Encouraged by such positive market conditions, we will continue to make the necessary management and financial investments to not only return Wright to higher levels of profitability as demonstrated in the past, but also implement targeted business strategies for sustained future growth, performance and success.

**"For 2006, we have focused our business strategies and resources into new products and expanded sales distribution that will enable Wright to return to its stated longer-term financial objectives of low to mid-teens top line growth and expanding operating margins as we exit the year."**

*F. Barry Bays,*
*Executive Chairman of The Board of Directors*

On March 22, 2006, Wright's board of directors announced the appointment of Gary D. Henley as the new President and Chief Executive Officer and Director, effective April 4, 2006. Mr. Henley has a distinguished record of accomplishments during his 24 years in the medical device industry, which include senior management positions with Smith + Nephew and most recently with Orthofix International NV, where he was President of the Americas Division, a publicly traded company. Mr. Henley will bring to Wright a strong track record of building shareholder value and experience in all facets of managing and strategically growing a global orthopedic medical company. With this appointment, I relinquished my position as Interim President and CEO and re-assumed the role of Executive Chairman of the Board of Directors. James T. Treace also relinquished his current position as Chairman and remains a director of the company.

Beginning our review of 2005, Wright's overall 7% global growth rate in 2005 was primarily driven by strong domestic performance of our hip and knee reconstructive joints, complemented by sales growth within our upper and lower extremity products offering. Our domestic reconstructive hip joint implants continued to see steady growth, reaching an annual growth rate of 18%. Key to this result was our continued market penetration with the PROFEMUR® modular neck implant system. This innovative product allows the surgeon to more precisely position the implant's femoral head in relation to the hip socket component, providing a greater range of motion for the patient. Additionally, several new femoral stem configurations incorporating the modular neck concept were introduced over the course of 2005 to broaden surgeon acceptance of the design. These new stem configurations allow the surgeon to choose a preferred stem style to specifically address the clinical needs of each patient.

In addition to modular necks, our high performance bearings significantly contributed to the sales growth in our hip products in 2005. Comprised of ceramic-on-ceramic, Big Femoral Head (BFH®) metal-on-metal bearings and the recently introduced cross-linked polyethylene option, our advanced bearing technology was a key driver within the hip product category.

Wright's 2005 domestic reconstructive knee product line achieved an annual sales growth rate of 11%. We experienced greater

market penetration with our ADVANCE® Medial-Pivot knee system due to enhanced minimally invasive surgery (MIS) instrumentation. This growth was complemented by the broader acceptance of our ADVANCE® Double-High tibial insert, which offers an improved range of motion and is suitable for the cruciate retaining segment of the total knee market.

Our domestic upper and lower extremity products provided a sales growth rate of 12% over 2004, primarily due to the introduction of our CHARLOTTE™ advanced foot and ankle system, along with continued surgeon awareness and acceptance of Wright's distal radius and elbow products. These products offer a strong platform for Wright to expand our distribution and market penetration within these respective customer segments. We believe that by providing innovative small joint products within the upper and lower extremity markets, complement-ed by our broad biologics solutions, we can continue to see low to mid-teen annual sales growth over the next several years.

In the biologics area, beginning in the latter half of 2004 and continuing throughout 2005 , sales were quite disappointing, demonstrating flat year over year growth. While this product segment has been a strong contributor to overall Company growth in past periods, 2005 saw significant changes in market dynamics in the bone graft substitute arena, resulting in negative sales growth. However, dramatic year over year growth was seen in the soft tissue segment, led by our GRAFTJACKET® family of products. Furthermore, Wright's biologics offering strongly complements our products within the upper and lower extremity and reconstructive joint markets. Returning this product segment to high single digit to low teen's sales growth over time, however, will require investments in additional field specialists and expansion within our distribution system.

Overall corporate performance during 2005 led to below-expectation financial results within the first three calendar quarters. In early October 2005, Wright pre-released our anticipated third quarter results and downwardly-revised its financial outlook for the remainder of the year. Shortly after that announcement, the Company accepted the resignation of Laurence Y. Fairey, then President and CEO, and simultaneously announced my interim appointment to the position. Then serving as the Executive Chairman of the Board, I had previously served as Wright's President and CEO from January 2000 through July 2004. At that same time, James T. Treace was appointed as Chairman of the Board, a position he had previously held from December 1999 to July 2004. Following these changes and over the balance of 2005, I have reorganized the senior management staff to provide a management structure capable of executing our targeted strategies for 2006. Under the new leadership of Gary D. Henley, our senior management will remain focused on the objective of returning the business to more predictable future growth, performance and success.

**Focusing On Financial Achievement**

Wright achieved another year of overall net sales growth, but had a disappointing net income performance, resulting in negative year-over-year earnings results. Lower-than-anticipated sales revenues within certain product segments, along with weaker European sales and an expense structure created for higher rates of sales, resulted in the company falling short of its original 2005 earnings expectations. However, since early in the fourth quarter of 2005, current management has undertaken initiatives to rationalize operating expenses and establish an appropriately-sized cost infrastructure that will support the our growth objectives. These steps are designed to return Wright to its corporate objective of creating bottom-line leverage and generate low to mid-teens sales growth by the end of 2006.

Net sales for 2005 increased 7% to $319.1 million from $297.5 million in 2004. The company's net income, as adjusted, for 2005 declined to

$24.9 million, or $0.71 per diluted share, compared with 2004 net income, as adjusted, of $26.5 million, or $0.75 per diluted share. Our key operating ratios significantly declined during 2005, with operating income, as adjusted, as a percentage of sales decreasing to 12.2% from 14.1% in 2004.

Wright's overall earnings performance was significantly influenced by the negative year-over-year sales performance of our U.S. biologics line and, internationally, by our European sales performance which was hampered by the transition of certain sales management and distribution personnel in southern Europe throughout the year. Our overall domestic sales revenues increased at a 10% rate, while overall international sales growth totaled 4%, yielding a combined global sales growth rate of 7% for 2005.

**"Ours is a performance-driven culture at Wright. We work hard to ensure resources get focused on what matters and that the initiatives we pursue will drive attractive financial returns. Our organizational philosophies, processes and reward systems reflect that we work for stockholders."**

*John K. Bakewell, EVP and Chief Financial Officer*

Our balance sheet remained very strong at the end of 2005, with the total stockholder's equity increasing by $16 million to $292 million at year end. We ended the year with cash and marketable securities totaling $76.3 million and net working capital of $196.1 million, while we continue to maintain an additional $60 million line of credit.

**Operating Results**

While we continued to make investments into various programs and infrastructure during 2005, those additional investments were not accompanied by accelerating sales growth, as anticipated. Therefore we did not meet our longer-term financial objective of maintaining low to mid-teens revenue growth while providing operating income results that exceed the revenue growth target. Nor did our SG&A see the typical leverage as seen in prior year-over-year comparisons, with SG&A, as adjusted, as a percentage of sales increasing by 0.7% to 51.1% versus 50.4% in 2004.

Wright's long-term objective is to reduce the overall SG&A percentage by one to one-and-a-half percentage points each calendar year. Although we do not expect our full-year 2006 results to meet our corporate growth and leverage objectives, it is our aim to return the company to such levels of performance as we exit 2006 and to sustain such performance during 2007 and beyond.

Corporate governance continues to be an area of importance and emphasis for us. We entered 2005 fully compliant with the new internal control systems requirements set forth by Rule 404 of the Sarbanes-Oxley Act of 2002 and continued to improve the overall efficiency of this system as we moved through the year.

In other operations matters, the global implementation of our business software continued in 2005 with most of Europe now converted to the J.D. Edwards system. We also expect to fully implement our Japanese operations to the same business system software in early 2007, which will result in complete integration of our international operations.

Our manufacturing operations did not change in any significant way over the course of 2005. However, implementation of additional cellular, or "lean", manufacturing techniques, coupled with our Six Sigma Quality program, allowed us to maintain a healthy gross margin, as adjusted, of 71.7%. We believe with anticipated product mix and steady efficiency increases each year, we should be able to maintain our gross margins at or near parity with our much larger competitors.

Regulatory activities associated with global product approvals were a very significant part of our business in 2005. We are required to seek and receive regulatory clearance for all new or significantly modified products prior to commercial distribution. In the first half of 2005, Wright received clearance from the United States Food and Drug Administration (FDA) for all of our tissue-containing ALLOMATRIX® bone graft materials. Globally, we are now filing regulatory approval applications at an average rate of 11 per month. This is a significant increase over 2004, due to additional regulatory requirements from agencies around the world. Looking to the future, we anticipate the FDA and many international regulatory agencies to continue to elevate their requirements for new product submissions, thus creating additional costs prior to any new product launches. However, through key investments made in 2005 related to additional personnel and new system

controls, we believe Wright is well positioned to meet this demand as it increases over time.

In 2005, our domestic reconstructive hip, knee and extremity businesses achieved several positive outcomes, due to the strength of the respective products within each segment. Our domestic hip sales reached a growth rate of 18%. This outcome resulted from combining our modular PROFEMUR® stem and neck implants with our very comprehensive high performance bearings, including our ceramic-on-ceramic and larger diameter metal-on-metal Big Femoral Head (BFH®) technology. This product offering fits extremely well with the trend toward smaller incision sizes associated with most total hip procedures today. Additionally, the combination of the modular necks and larger femoral heads dramatically reduces the chance for the most common and dreaded post-operative complication — *dislocation*. The larger head and modular neck combination is actually providing some surgeons with the confidence to modify their patients' post-operative protocols without concerns over dislocation. Under these surgeon-initiated protocols, patients are free to return to normal activities with little or no post-surgical restrictions. Additionally, we are aggressively developing alternative surgical approaches to help reduce patients' hospital stays and decrease the level of both pain medications and therapy required following hip procedures.

Our 2005 domestic knee performance improved over 2004 by 11%, largely due to our development of improved instrumentation for standard and MIS surgical approaches. Additionally, we have seen continued market acceptance of the new ADVANCE® Double-High tibial insert, which offers a higher degree of flexion and stability, allowing surgeons to use our ADVANCE® Medial-Pivot femoral component within the cruciate-retaining segment of the total knee market. Together, our improved instrumentation and new tibial inserts were the primary contributor to this year's increased domestic performance in knees.

Domestic extremity performance maintained strong momentum throughout 2005, reaching 12% year-over-year sales growth, driven largely by additional interest in and conversion to our new CHARLOTTE™ Foot and Ankle products. To promote further growth in extremities, we are targeting the distal radius surgery segment through both existing and new products. We believe we have made good progress in penetration of this market with fracture fixation implants like our LOCON® VLS plating system and innovative MICRONAIL™ internal fixation device. Various surgical meetings and medical


**"Today's patients demand surgical treatments that allow them to quickly return to their active lifestyle.**

**Wright is at the forefront of providing innovative products and technologies that address the high expectations of our surgeon customers and their patients."**

*Jeffrey G. Roberts,*
*Senior Vice President & Chief Technical Officer*

I Invite You To Read More

Regenerative Tissue Technology

Intramedullary Distal Radius Fixation

Application-Specific Foot & Ankle Fixation

"The complementary nature of our biologics and extremity products gives us a powerful competitive advantage in the market.

Our strategy for 2006 growth involves focusing this advantage on targeted market segments such as the foot and ankle, distal radius and shoulder."

*John T. Treace,*
*Vice President*
*Biologics &*
*Extremity Marketing*

I Invite You To Read More



journals are beginning to highlight clinical results which confirm that the MICRONAIL™ system yields an earlier return to normal wrist motion, with less swelling and subsidence of bony fragments during the healing process. We believe this internal fixation technology, which is patented and controlled by Wright, may position us to become the dominant provider of fracture fixation devices within the distal radius repair market. It is also important to note that our products for the distal radius, foot and ankle, elbow and shoulder have been greatly enhanced by the incorporation of our bone graft injectable putties, as well as our exclusive GRAFTJACKET ® soft tissue material. Offering such complementary product combinations allows surgeons the convenience of dealing with one supplier for a wide array of clinical needs.

**New Products and Market Dynamics**

Wright continues to make significant global investments within the R&D area, which also includes regulatory compliance and clinical affairs. Investments in these areas increased in 2005 by 21% over 2004 levels. In 2005, a total of $22.3 million was invested in R&D, representing a $3.9 million increase over 2004 levels, resulting in R&D expense totaling 7% of sales in 2005. Higher expenses in this area were due to a global increase in fees for regulatory submissions, as well as requirements for additional and more comprehensive preclinical testing to support submissions. Clinical monitoring will continue to be a large contributor to the annual increase in expenses associated with the development of new products that are subject to Investigational Device Exemption (IDE) studies and Pre-Market Approval (PMA) clearances.

Capitalizing on our innovative new products requires global sales force expansion and development. We have a history of introducing three to four significant new products within each calendar quarter. To support this level of new product launches, Wright increased its domestic sales force in 2005 by 1%, bringing our domestic total to approximately 320 exclusive distributors and salespeople. Our international direct and dealer sales network increased by 24% to support sales outside the United States.

A major new product introduction in 2005 was the launch of our advanced metal technology, the A-CLASS™ Series metal. This wear-reducing material significantly enhances our metal-on-metal total hip replacement offering, and has been well-received by surgeons. We believe this technology will help keep us on the leading edge of the emerging "hard bearings" market. Our A-CLASS™ technology significantly reduces the potential for metal wear debris and sets Wright apart from other competitors with metal-on-metal devices. We believe that, over time, this material will provide the most robust hard bearing surface for the majority of patients. It is also our belief that the long term preferred bearing option in the United States, Europe and Japan will be metal-on-metal

articulation, versus ceramic-on-ceramic or cross-linked polyethylene options.

During 2005, we also completed development of several proprietary minimally-invasive surgical techniques and instrumentation for both total hip and knee procedures. Over the next several years, we see these new surgical platforms as the catalyst for future growth within their respective markets. Unlike more conventional surgical techniques, our innovative minimally invasive procedures and new instrumentation will help patients recover more rapidly, making it possible for them to begin limited movement immediately following surgery, without severe pain or impairment. We anticipate that most patients treated with these techniques will be able to walk with little or no assistance within 24 hours of their procedure and be discharged within the second day following surgery. We believe these innovative procedures, combined with our wide variety of surgical implants, will position us as a provider of solutions for reducing orthopaedic healthcare costs.

In recent years, development of bone-conserving implants and techniques has been a point of focus within the orthopaedic industry. Wright's approach to offering a bone-sparing implant has centered on hip resurfacing, which allows the bony surfaces of the hip ball and socket to be replaced with a metal cup and spherical hollow ball. In this procedure, very little bone is actually removed, whereas with conventional total hip surgery the bony end of the femoral ball is completely excised. Our product is called the CONSERVE® Plus Resurfacing System. Currently, this product is under PMA review by the FDA for distribution and sale within the United States. While the process has taken much longer than anyone could have predicted, we are optimistic that the product will be cleared by the FDA. We believe that this product can address not only the clinical needs of the typical total hip candidate, with an average age of 65 years, but also the younger patient population, with an average age of 55 years. The primary determination of whether our resurfacing system is appropriate for a particular case is whether

**In Focus: Hip Resurfacing Technology**

For over ten years, Wright has aggressively pursued the development and international marketing of our CONSERVE® Plus implant.

Now we are eager to share this total hip resurfacing option with surgeons in the United States. Optimistic that regulatory clearance will be obtained, Wright is ready to immediately pursue domestic sales. "From a manufacturing standpoint, we've mobilized the appropriate tooling and production resources to meet the anticipated volume of a CONSERVE® Plus domestic launch," stresses **William J. Flannery,** Vice President of Logistics and Materials.

Complementing our preparation for production needs, we have developed thorough education programs for both our sales force and surgeons. According to **John R. Treace,** Executive Vice President of North American Sales , "We expect this remarkable technology to generate a great deal of interest among U.S. surgeons and their patients, and we are ready to meet the demand. The hip industry has seen few design concepts that equal the innovation of resurfacing. Wright will be privileged to offer such a revolutionary device to our domestic customers."

**"We are focused intently on bringing CONSERVE® Plus hip resurfacing to the U.S. market.**

**We believe that this innovative alternative offers compelling clinical advantages to those patients whose condition can be addressed with a more bone-conserving approach."**

*Joel K. Batts,*
*Sr. Director of Clinical Affairs*

*Wright's CONSERVE® Plus Total Hip Resurfacing Implant*

*Pending FDA clearance. For investigational use only in the U.S.*

(from left to right)

Joel K. Batts,
Sr. Director of Clinical Affairs

William J. Flannery,
VP of Logistics & Materials

John R. Treace,
EVP, North American Sales

What could a joint resurfacing device like our CONSERVE® Plus hip implant mean for younger patients living with chronic, debilitating pain? It may serve as a significant option to total hip replacement or pain management therapy and the chance to return to activities they love.

Wright's CONSERVE® Plus implant combines the benefits of metal-on-metal articulation with a bone-conserving design. For a younger patient, the metal-on-metal feature means less wear and more durability for an active lifestyle. And the implant's reduced-stem design means that the femoral canal is never breached, leaving far more bone untouched than in a total joint replacement procedure.

**In Focus: Patient Testimonial**

Danny Dring is an internationally recognized, award-winning martial artist who has earned six gold medals and two silver medals in international competition.

As a performing artist, Danny has always been acutely aware of his own body. His training regimen included all the things athletes would normally do to keep in shape – running, lifting weights and stretching, in addition to his martial art training. So, when he started experiencing pain in his hip, he knew immediately there was a major problem.

In 2003, things couldn't get any worse. It hurt for Danny to sit, lie down, be still and stand up. He was teaching all over the country and after each seminar would lie in his hotel room in agonizing pain.

Danny researched his options, found his way to Dr. Harold Boyd in Salem, Oregon, and was accepted into the clinical trial for Wright's CONSERVE® Plus total resurfacing arthroplasty. He underwent the procedure in May of 2003, with Dr. Boyd and was walking on crutches and climbing up and down stairs the next day after surgery.

In mid-November, five months after surgery, he hit his Chinese splits for the first time in years. According to Danny, "The non-stop throbbing in my hip is gone. The 24/7 aches and pains are gone. I am finally getting a full night's sleep – no more moaning and groaning."

*Individual patient results vary.*

**"This surgery has fundamentally given me my life back – my ability to earn my living teaching, training and exercising."**

***Danny Dring***

***Osteoarthritic patient successfully treated with CONSERVE® Plus Total Hip Resurfacing during its clinical trial***

the patient has good bone quality within the femoral ball. We see the opportunity for this product easily reaching 10% of the U.S. total hip market, which translates into approximately a $200 million market segment. Once the product is cleared by the FDA, we will immediately move forward with our surgeon training and educational programs in the United States.

Within the biologics business, our GRAFTJACKET® Regenerative Soft Tissue product continued to demonstrate much greater acceptance within all market segments during 2005. To augment the clinical successes, the Company was very active in working with the various federal and state agencies to assure appropriate financial reimbursement for not only the material, but the surgical fees, office visits and associated healthcare provider fees. The GRAFTJACKET® product and the clinical uses for most indications are now covered by reimbursement codes from the Centers for Medicare and Medicaid Services (CMS). These reimbursement codes allow our sales and distribution network to aggressively pursue use of the product within all areas of orthopaedics and the diabetic foot ulcer market. While there have been competitive pressures within this product area, the unique properties of revascularization, strength, ease of use and clinical performance have proven to be the determining factors by which many surgeons have chosen our GRAFTJACKET® material over other competitive products. Looking to the future, Wright will continue to invest in new product development globally at an annual rate of 6% to 7% of sales.

**International Activity**

International revenues accounted for 38% of our total revenues in 2005, with a year-over-year growth of 4%. The year was challenging, due to continued rebuilding within our European organization, particularly in northern Italy and southern France. We believe that with the May 2005 appointment of a new European President, Mr. Paul R. Kosters, and his proven track record of leadership, we will continue to make great strides in Europe for improved results in the future. Working toward those improved results, Mr. Kosters has reorganized the sales and distribution organization to allow for expanded market penetration in regions not pursued previously, such as Germany, the Scandinavian

— continued on page 9

**Focusing on International Growth**

With 38% of the company's total 2005 revenues derived from sales outside the U.S., international growth continues to be a primary point of focus for Wright. Surgeons in over 60 countries look to Wright for cutting-edge solutions to their orthopaedic challenges. We are eager to deliver and extend our reach into additional international markets.

One overseas market in which we achieved marked growth in 2005 is Japan. "Since establishing a direct distribution business in Japan, we've achieved greater control over the execution of key marketing strategies to target the unique needs of surgeons in this region," notes Karen Harris, Vice President of International Sales and Distribution. In 2005, we continued to expand our base of sales personnel for this subsidiary, resulting in 20% growth in sales in Japan. Hip offerings like the PROFEMUR® Z stem with modular neck technology and the PERFECTA® RS II stem were significant contributors to this growth, with overall hip sales in Japan ending 43% above the prior year's levels.

**"Distribution expansion, training and a constant building of surgeon relationships have really strengthened our business in Japan."**

*Karen L. Harris,*
*VP International Sales & Distribution*

Since its establishment, Wright Medical Japan has grown to employ 59 administrative personnel in five cities, as well as 29 direct sales representatives. Over the course of 2006, the subsidiary will focus on further expansion of its direct distribution network.

As we move through the year, we hope to establish similar growth in the European marketplace. Following country manager changes within our European subsidiaries in 2004, the company faced significant distribution and sales challenges. However, an aggressive, dedicated, new management team has developed and implemented sound, targeted strategies to put Wright's growth in Europe back on track.

Central to these strategies has been the process of taking a closer look at the perception of Wright within the European orthopaedic community. "We found that while many surgeons were familiar with our core large joint offering, they were much less familiar with our procedure-specific products," explains Michael Green, Vice President of Marketing for Europe, the Middle East and Africa. "These are very unique products that show Wright is a technology-led company," Green notes. To emphasize this strength, our European team developed an indication-led marketing plan. This marketing strategy is enhanced by newly established medical education programs, including Centers of Excellence for surgeon training. As we continue to expand our reach in Europe, an emphasis on innovative procedure-specific solutions will drive our pursuit of new business.

The cultivation and preservation of Wright's corporate brand is also a key component of our growth strategy for Europe. Management has taken key characteristics and tightly wound them into the company's branding strategy for the market to leverage Wright's valued reputation as a smaller, more agile and more personal orthopaedic company. Throughout Europe in 2006, we will strive to invigorate growth by converting our undeniable passion for orthopaedics into sales success.

**"Again and again, we've heard surgeons say they like working with Wright because the company reacts quickly and displays a passion for orthopaedics that many of the larger companies seem to have lost."**

*A. Michael Green,*
*VP of Marketing Wright Medical Europe, SA*

countries, Austria and Switzerland. Furthermore, utilizing the Center of Excellence established at Oxford University, along with key surgeon training programs in Belgium, our training and educational activity for the European surgical community has been dramatically enhanced for 2006. We expect to conduct several CONSERVE® Plus resurfacing training courses in Oxford and Belgium throughout the year.

Our Japanese business saw another good year of sales growth and business expansion in 2005. We continue to increase our employee direct distribution network within Japan to support continued acceptance of our hip and knee products. By year end, our sales force had increased to 29 direct sales representatives.

Product introductions within all of our international markets are becoming more challenging due not only to significant increases in regulatory submissions, but also more stringent requirements which are similar to those of the United States. These additional hurdles in seeking and receiving product approvals have required an increase in our international regulatory expense and infrastructure. The Japanese market is by far the most restrictive and arduous for regulatory review and approval. Due to regulation changes in early 2005, approvals have dramatically slowed for all orthopaedic companies doing business within the Japanese market.

While the overall performance of our international business was not what we had anticipated for 2005, we believe that the changes in our European management, along with the continued improvements in our Japanese and other distributor and export businesses, should position us for improved year-over-year growth in 2006.

**Targeted Strategies for the Future**

Before looking to the future, it is important to note that the achievements and successes in 2005 would not have been possible without the tireless efforts of all our employees worldwide, along with the support of our Board of Directors and management team. Our stockholders, customers and employees continued to support Wright, even with our less than anticipated financial performance, and for that we are very appreciative.

As we look to 2006 and think about employing our targeted strategies for future sustained growth, performance and success, we also must refocus our attention to the fundamentals that have made this business successful over the years. We believe that we have excellent products that can benefit a broader cross-section of orthopaedic surgeons and patients worldwide. We also believe that by focusing more of our resources into our global distribution and sales force, those investments will position us for improved results over the course of 2006 and beyond. While our time-line for the FDA approval of the CONSERVE® Plus resurfacing system has been much longer than anticipated, our outlook for ultimate approval remains bright. Once on the market, we expect that the CONSERVE® Plus system will allow us to be much more assertive in attracting new potential total hip surgeons to this bone-conserving product concept. Furthermore, linking our improved tissue preserving surgical techniques and implant systems for both total hip and knee procedures should generate more opportunity for surgeon conversions through improved patient outcomes.

In extremities, our expectations for increased awareness within the wrist and elbow segments have never been better, due to the clinical successes of our MICRONAIL™ internal fixation device and our market-leading EVOLVE® Radial Head system. Likewise, the continued acceptance of both the CHARLOTTE™ foot and ankle system and the GRAFTJACKET® regenerative soft tissue product offer substantial market opportunities due to their unique designs and surgeon-supported clinical results.

As we look to future growth and improving financial performance with the recent appointment of Gary D. Henley as the new President and CEO, supported by the current management team and working closely with the Board of Directors, Wright is in an excellent position for meeting its long-term objectives of low to mid-teens growth in top line revenues and producing equal or greater growth in operating income. Also in the coming year, we anticipate continued strong competitive activity globally. However, we believe that we are well positioned to address those competitive challenges. Furthermore, by employing our targeted strategies for future sustained growth, performance and success over 2006, we believe the long-term expectations of our stockholders, customers, and employees will be achieved.

Sincerely,

F. Barry Bays
Executive Chairman of the Board

# focus on wright.

## Senior Management

**Gary D. Henley**
President & Chief Executive Officer

**John K. Bakewell**
EVP & Chief Financial Officer

**John R. Treace**
EVP, North American Sales

**Paul R. Kosters**
President, Wright Medical Europe, SA

**Jeffrey G. Roberts**
SVP & Chief Technical Officer

**William J. Flannery**
VP, Logistics & Materials

**Kyle M. Joines**
VP, Manufacturing

**Aldo M. Denti**
VP, OrthoRecon Marketing

**John T. Treace**
VP, Bio & Extremity Marketing

**Jason P. Hood**
VP, General Counsel & Secretary

**Lance A. Berry**
VP & Corporate Controller

**Karen L. Harris**
VP, Intn'l Sales & Distribution

**Joyce B. Jones**
VP & Treasurer

**Steven A. Kahn**
VP, Regulatory/Clinical Affairs & Quality

**William F. Scott**
VP, Sales & Marketing Services

**Eric A. Stookey**
VP, US Sales

## Directors

**F. Barry Bays**
Executive Chairman of the Board
Wright Medical Group, Inc.
Director since 2000

**Martin J. Emerson**
President & Chief Executive Officer
American Medical Systems, Inc.
Director since 2006

**Gary D. Henley**
President & Chief Executive Officer
Wright Medical Group, Inc.
Director since 2006

**Beverly A. Huss**
Senior Adviser
Pervasis Therapeutics Corporation
Director since 2006

**David D. Stevens**
Chief Executive Officer
Accredo Health, Inc.
Director since 2004

**James E. Thomas**
Managing Partner
Thomas, McNerney & Partners, LLC
Director since 1999

**Thomas E. Timbie**
President
Timbie & Company, LLC
Director since 2000

**James T. Treace**
President
The J&A Group, LLC
Director since 1999

## Wright's Core Values and Beliefs

Always do the right thing for our stockholders, customers, and employees.

Have passion for your job and enlist the willing cooperation of others.

Have a sense of urgency to win every day.

Don't run out of cash. No matter what.

No surprises. Tell the bad news first, not last.

Create true value — not through paper or gimmicks.

Maintain an employee-friendly environment.

Only surround yourself with high performers. Make it a challenge to get on board and hard to leave.

Those buy from those who teach.

Be careful. A little success can create a lot of overhead.

Have fun with your job.

**Executive Committee**
F. Barry Bays*
Gary D. Henley
James T. Treace

**Nominating & Corporate Governance Committee**
Thomas E. Timbie*
Beverly A. Huss

**Audit Committee**
David D. Stevens
James E. Thomas
Thomas E. Timbie*

**Compensation Committee**
David D. Stevens*
James E. Thomas
Beverly A. Huss

**denotes chair*

**Annual Meeting**
The 2006 annual meeting of Wright stockholders will be held
**May 11, 2006**
beginning at 3:30 CST at the
Doubletree Hotel, Executive Meeting Room
5069 Sanderlin Avenue Memphis, TN 38117

# focus on biologics.

## Human Dermis – Regenerative Tissue Technology

In 2005, nearly 17 million Americans were living with diabetes. For 15% of that population, those challenges included foot ulcers — a serious complication that leads to over 70,000 lower extremity amputations each year. In addition to the adverse effects on thousands of lives, these amputations result in $1.1 billion of healthcare costs annually. These alarming statistics underline the importance of ground-breaking, cost-effective wound treatments like Wright's GRAFTJACKET® Ulcer Repair Matrix.

**"Being granted billing codes in 2005, laid a foundation to establish GRAFTJACKET® products as a standard of care for hard-to-heal ulcers."**

*Sajini J. Thomas*
*Director, Reimbursement Services*

In the past year, access to treatment with this remarkable innovation in wound care was simplified through implementation of three new Medicare billing codes. GRAFTJACKET® wound care materials are now reimbursable in all standard treatment settings, which gives thousands of foot ulcer sufferers a new option for successful treatment without amputation. "The billing codes serve as critical identifiers for our products, placing them among the most widely-accepted treatment options in the wound care market," explains Sajini J. Thomas, Director of Reimbursement Services. The codes have opened the door to establish


GRAFTJACKET® products as a community standard of care for hard-to-heal wounds.

In addition to improving patient access to innovative and effective care with our GRAFTJACKET® products, the billing codes ensure better coordination of benefits for those with secondary insurance and minimize patients' out-of-pocket costs.

**"I was so nervous I would need an amputation to keep the infection from spreading to the rest of my body. I hoped for a miracle that I would be able to keep my foot and all five toes."**

**Zandra Gilbert**
Diabetic foot ulcer patient
*successfully treated with GRAFTJACKET® Ulcer Repair Matrix*

## Steve's Experience

Dr. Stephen A. Wasilewski, an orthopaedic surgeon in Ketchum, Idaho, has been in practice for years and is used to performing surgeries on patients for a variety of conditions. However, he never thought an injury would actually turn him into a patient on the operating table.

That all changed one day during a routine round of golf when Dr. Wasilewski felt an immediate and intense pain in his shoulder. An MRI revealed a massive rotator cuff tear. Back at work the following week, the pain intensified to the point that he could not perform a typical two to three hour surgery (orthopaedic surgery can be fairly demanding physically on the surgeon). His rotator cuff injury caused the range of motion and function of his arm to be limited and, ironically, performing shoulder surgery was a particular challenge for him. The pain he continued to experience impacted things in his everyday life as well. Golf was a thing of the past. Dr. Wasilewski realized that his injury needed urgent professional care.

He consulted with many specialists in the field and came across Dr. Stephen J. Snyder who was using GRAFTJACKET® Regenerative Tissue Matrix, from Wright, for challenging rotator cuff tears. Since it is made from donated human tissue, GRAFTJACKET® Matrix is easily recognized and accepted by the body enabling the graft to act like a scaffold for new tissue construction. And, over time, it is converted by the body into functional tissue.

Besides the science behind the product, Dr. Snyder also explained how he used the product in a minimally-invasive surgical technique. Unlike more radical, invasive surgical approaches that use more of the patient's own tissue for the repair, there is less risk associated with use of GRAFTJACKET® Matrix since less of the patient's tissue needs to be taken from elsewhere in the body.

Dr. Wasilewski decided to proceed and as part of the surgical repair, GRAFTJACKET® Matrix was utilized to fully reinforce his damaged anatomy.

Today, Dr. Wasilewski is doing very well. His rehabilitation period was relatively easy following surgery and he hasn't experienced major pain or range of motion limitations. After nine months, he was back playing golf and playing well. During his third round of golf, he shot the first eagle of his golf career! In addition, he is now able to perform surgeries again, without pain.

**"I would definitely recommend that patients talk to their doctor about GRAFTJACKET® Matrix as a treatment option for rotator cuff repair. I am very pleased with the result of my surgery."**

## Why Wright?

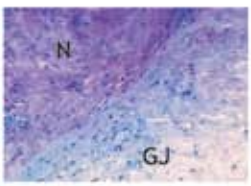
### What Makes The GRAFTJACKET® Matrix Different From Other Companies' Grafts?

GRAFTJACKET® Regenerative Tissue Matrix is a graft made from donated human tissue. This readily distinguishes it from other competitive grafts which are, instead, derived from bovine (cow) or porcine (pig) sources.

Because GRAFTJACKET® Matrix is actual human dermis, a patient's body readily recognizes it since it is very much like its own tissue. This enables GRAFTJACKET® Matrix to provide an excellent environment for the body to grow new tissue by quickly re-establishing blood supply and cellular activity. In other words, the graft acts like a scaffold for new tissue construction. Over time, it is converted naturally into soft tissue, tendon or ligament, depending on where it is implanted in the body.

Bovine- or porcine-derived grafts, in contrast, cause an inflammatory response in the body as the body sees them as "foreign" and sets about attacking them, as opposed to readily accepting them. Instead of functional tissue, the body converts those grafts into scar tissue.

GRAFTJACKET® Matrix
Sutured in place




Proteoglycan staining indicating neotendon formation (N) and integration with GRAFTJACKET® Matrix (GJ)
HUMAN HISTOLOGY FROM 3-MONTH ROTATOR CUFF REPAIR CASE | Toludine Blue 25x

# focus on extremities.

## Application-Specific Needs for Foot & Ankle

Wright is keenly aware of the unique challenges orthopaedic surgeons face when treating the foot and ankle. The delicate anatomy and network of critical tendons in this area require a specialized surgical approach and deserve a highly refined set of implants like the CHARLOTTE™ Fixation System. According to Senior Product Development Engineer Mary McCombs, "Most of our competitors provide broad-use trauma products for this part of the anatomy. But we've developed an implant system that targets specific procedures in the foot and ankle." CHARLOTTE™ implants like the MTP Fusion System for treatment of the first metatarso-phalangeal joint and the Quick Staple for use in the first proximal phalanx allow surgeons to deliver precise compression in a specific area with minimal disruption to the surrounding delicate structures.

**"We're definitely unique from the larger orthopaedic companies when it comes to focus in the foot and ankle area."**

*Chad Patterson and Mary McCombs*
*Senior Engineers, Product Development*

Our CHARLOTTE™ foot and ankle fixation line is a strong response to surgeon demands and patient needs in a highly specialized market segment that is both science and art.

As Senior Project Engineer Chad Patterson explains, "We aligned ourselves with some of the best surgeons in the field and got that classic '1 plus 1 equals 3' result with the CHARLOTTE™ system. With this procedure-specific family of implants as a foundation, we will continue to meet the unique and evolving needs of the foot and ankle market."




"I was nervous about the surgery. But, after it was over, my foot looked normal (it had been swollen before). And, after all the pain I've been through, I feel like the Phoenix rising from the ashes."

Brian Emery
*successfully treated with the CHARLOTTE® MTP Fusion Plate*

## Eleanor's Experience

**"I don't lift bricks or anything like that. But I'm able to do all the things I need to do, and it makes me feel safer."**

Eleanor Gabrielsen, 74, said she feels a bit like the "bionic woman" with a titanium rod in her right wrist: stronger, more confident, able to do anything she wants to do. She likes that feeling.

She fell twice in 2004 during a five-month period and, both times, broke her wrist.

In the first fall she was in line at a post office and tried to step over one of the velvet ropes used for cordoning off a section, and her coat snagged and made her lose balance. She automatically put out her right hand to break the fall, and the impact fractured the bones in her wrist near the hand.

Virak Tan, MD, Associate Professor of Orthopaedics at New Jersey Medical School, set the wrist and fixed her arm in a traditional plaster cast for six weeks, after which Gabrielsen did physical therapy to regain strength and motion in her arm and hand.

In her second fall, she was about to get into a car when she stepped on a ledge that toppled her over. This time the break was worse, and in about the same area of her right wrist. Dr. Tan told her that traditional closed treatment could be tried again, but there was a good possibility that it might not work as well as the first time because this was a more severe break. Additionally, because Gabrielsen wanted to get back to her activities quickly, Dr. Tan recommended a new approach to treating wrist fractures, the MICRONAIL™ Intramedullary Distal Radius

System. It is a surgical wrist repair device that resides completely inside the bone (that "bionic" titanium rod Gabrielsen referred to) and requires a less-invasive surgery with less scarring than traditional plating devices.

"That sounded great to me," she said. "It was a simple, one-day surgery, and I liked the idea of having that extra support. The follow-up therapy went much faster and better than with the first break, so I was delighted. And, it has been very successful."

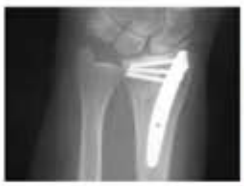
Just three weeks after the surgery Gabrielsen said she was feeling good and was able to use her typewriter and do just about everything she wanted to do. She has experienced no pain in her repaired wrist, and she has strength and complete freedom of motion that allow her to feel both comfortable and confident again.

**"I'm back to normal as if nothing ever happened. It really amazes me."**

## Why Wright?

### Why Is MICRONAIL™ Fixation Different From Other Companies' Wrist Solutions?

Approximately 300,000 wrist fractures are treated in the U.S. each year. However, the standard of care for this type of break, most common in middle- to late-aged females, hasn't changed for decades. Until now.



MICRONAIL™ System
Completely in bone

Traditional treatment options can have complications, including pain and loss of function caused by the implant being placed on the exterior of the bone. The MICRONAIL™ system addresses these common concerns and also allows patients limited use of their injured wrist almost immediately following surgery.

The MICRONAIL™ System is implanted completely inside the bone, providing immediate stability and eliminating the possibility of irritation to surrounding soft tissue. In addition, the less-invasive approach used to implant the device allows patients a more speedy recovery.

The MICRONAIL™ System requires only a 2-3 cm incision, allowing for minimally-invasive (MIS) surgery
CONVERSELY, TRADITIONAL PLATING SYSTEMS TYPICALLY REQUIRE A 5-6 INCH INCISION

# focus on hips.

## Flexibility – PROFEMUR® Modular Hip System

A key element of successful total hip replacement is achievement of an implant fit that closely mimics the feel and function of a patient's natural hip joint. For decades, the standard hip stem design has featured a one-piece implant with a fixed neck position.

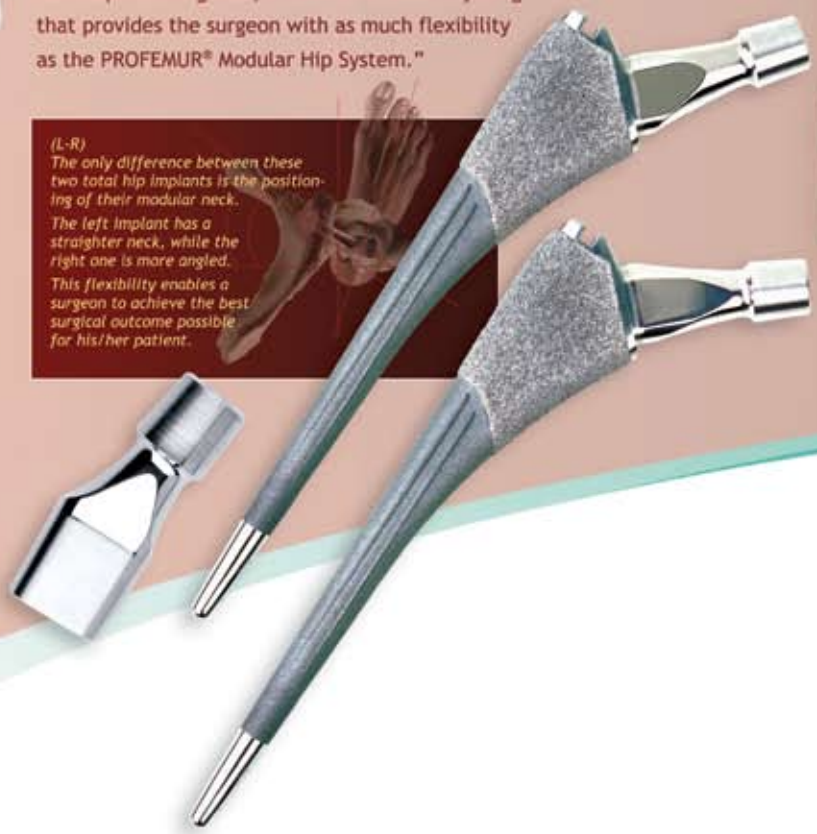
"A problem with fixed neck implants is that the surgeon sometimes has to increase the patient's leg length to properly balance the soft tissue for a stable hip," explains Brian McDaniel, Director of Hip Product Development. "And, a fixed neck implant doesn't allow the surgeon to do that." As a result, leg length discrepancy (one leg feeling slightly longer than the other postoperatively) is the number one complaint from patients who have hip surgery.

Wright provides a solution to this challenge through the PROFEMUR® System, featuring modular neck technology. This unique design focuses on built-in flexibility to suit a wide range of patient anatomies. "With PROFEMUR® modular neck technology, the surgeon can achieve a stable hip without compromising leg length," notes McDaniel.

Modular pieces of the PROFEMUR® total hip allow the surgeon to first focus on a proper stem fit, then move on to selection of an appropriate neck unit to achieve the desired offset and leg length to accommodate each patient's unique anatomy (as some of us are naturally more "knock-kneed" or "bow-legged" than others). Mike Carroll adds, "In my 15 years as a product development engineer, I have never seen anything that provides the surgeon with as much flexibility as the PROFEMUR® Modular Hip System."

**"Every time we show the system to a new surgeon, they are blown away at how simple, yet revolutionary, the concept is."**

*Mike Carroll and Brian McDaniel*
*Directors, Product Development*



*(L-R)*
*The only difference between these two total hip implants is the positioning of their modular neck.*
*The left implant has a straighter neck, while the right one is more angled.*
*This flexibility enables a surgeon to achieve the best surgical outcome possible for his/her patient.*

## Sana's Experience

**"I had been living with lots of pain. It kept getting worse, and I kept losing more and more of my strength and flexibility."**

Sana Sims is an elementary school principal and a competitive martial artist. She was trained to endure physical pain and push her limits to the max.

Because of that training and endurance, it took Sims about seven years to discover that an old hip injury had caused severe deterioration of the joint and only total hip replacement could bring her back to 100 percent. She tried an intense physical therapy program. She tried acupuncture. She went to a sports medicine specialist and received cortisone shots in the hip.

"I tried everything I could think of but nothing was really working," Sims said.

Finally she consulted with Joseph J. Ciotola, MD, an orthopedic specialist in Baltimore. His x-ray showed that Sims' hip joint was worn down to the bone. It wasn't a question of if she needed total hip replacement, but when."

Ciotola considered Sana's age, health and activity level and recommended Wright's Big Femoral Head (BFH®) hip implant because it allows the greatest range of motion on the market – a real benefit for active patients. "I knew because of her Taekwondo she was going to put a lot of stress on the joint and test its limits," Dr. Ciotola said. "Sana is in such good physical condition, and so physically aggressive, the BFH® was definitely the way to go for her."

Rehab and physical therapy were not a problem for Sims, and she returned to her demanding Taekwondo training just five months after surgery. And, at about a year post-surgery, she tested and passed her second black belt exam which included a rigorous four-hour endurance test, followed by upper body techniques, forms, sparring, and board breaking.

Sana attributes research-based training, an "I Can" attitude, and her new hip to her success.

"The hip is extremely important in Taekwondo," she said. "With the kicks, it all starts in the hip. I'm glad to say the new hip is performing well. I'm having no pain and I'm probably back to 90 percent of where I was. And I'm better in some ways; my kicks are actually higher."

**"It's a very good feeling. Emotionally. Physically. It feels good in every way."**

*Traditional Metal Wear* *A-CLASS™ Metal Wear*

## Why Wright?

### What Makes Wright's Metal Hip Implants Better Than Other Companies'?

Hip implants that are made from metal components wear better and last longer than traditional hip implants that are made of metal and plastic. However, Wright offers metal-on-metal hip implants that are superior to any other found on the market today, thanks to the patented A-CLASS™ Advanced Metal.

Wright has specifically developed its A-CLASS™ Metal to reduce wear and increase implant lifespan. The result is a patented metal hip replacement that differs from competitor's designs because it features, (1) a 90% reduction in initial wear and 68% reduction in lifetime wear of the implant, as well as, (2) a large diameter femoral component that more closely matches a patient's natural anatomy. Wright's BFH® Technology is designed to provide implanted patients with increased range of motion and reduced chance of dislocation, in addition to reduced wear – truly, the best of all worlds in one hip replacement system.

A-CLASS™ Metal From Wright Wears Up To 68% Less Than Other Manufacturers' Metal Implants
Wear Simulated Test Data ($mm^3$ per 5 million cycles)

# focus on knees.

## Minimally-Invasive Surgery (MIS)

Ideally, an MIS approach to total knee replacement allows the surgeon to avoid having to move the patella or cut the quadriceps muscle or quadriceps tendon. Theoretically, using this less invasive approach to surgery allows patients to experience faster recovery and less postoperative pain.

### What Does The Data Show?

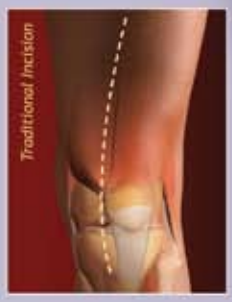
Preliminary results have consistently shown patients experience decreased blood loss, less pain, and earlier range of motion with MIS knee surgery.

**"We are committed to making MIS knee procedures easier to perform. Patients want it, and surgeons want to offer a procedure without compromising the surgical outcome."**

*Aldo M. Denti, VP OrthoRecon Marketing*

### Wright's Focus On MIS

ODYSSEY™ MIS Knee instrumentation was developed to provide the surgeon with instruments specifically designed for surgery that will take place within a smaller incision (on average 4-6 inches, as opposed to the 8-12 inches of a traditional knee surgery).


Minimally-invasive surgery is not only about the size of the incision, but also the amount of soft-tissue damage that takes place below that incision. Wright's instruments are designed to minimize this as well, which will greatly assist with alleviation of pain and faster rehabilitation after the surgery takes place.

When combined with ADVANCE® knee implants designed to provide natural knee motion, ODYSSEY™ MIS instrumentation may significantly improve the results of total knee arthroplasty.

## Don's Experience

**"I was 48 years old, overweight, out of shape, and my physical problems deprived me of things I enjoyed. Now, I'm back. I've got a physically active future again."**

Don Lambert's triumph in reaching the peak of Mt. Kilimanjaro started with a moment of truth during a pre-operation class with other patients preparing for knee surgery. "I was there for a retread of a worn-out part to reclaim an active life," he said.

The "retread" was for his athletically-favored left knee that essentially wore out from many years of rough activity. The constant pain took its physical and mental toll on Lambert. He lost interest in doing active things and that caused more physical limitations due to weight gain.

On May 7, 2003, Lambert received a total knee replacement through MIS knee surgery with an ADVANCE® Medial-Pivot Knee implant.

And that's when the hard work began. He committed himself to physical therapy, and made the decision to carry it on to an ultimate goal — lose the extra 70 pounds he was carrying, get into shape and take back his life.

"When I heard about an opportunity to climb Kilimanjaro, I believed it could be my audacious act. It was hard and dangerous enough to motivate me, yet achievable enough that I believed I could succeed. It was something I needed to do for myself and others who had been in my situation," he said.

He focused on a nutrition plan and an ambitious physical health regimen. He received the support of his wife, friends, and his knee surgeon, Robert Hagen, MD.

On September 19, 2005, after eight days and 45 miles of mountain hiking and occasional rock climbing, Lambert reached the 19,340 foot summit of Mt. Kilimanjaro. In his photo at the peak, Lambert is holding a sign that says, "Thank You Wright Medical. Your Knee Got Me To The Top."

"I was pleased at how well the knee performed," he said. "I really tested it on the mountain and found I relied on it, especially during the descent."

Lambert said having his knee replacement was one of the best decisions of his life, and he is a strong proponent of "not waiting." He has talked to numerous people who said they were told they were too young for joint replacement. "Nonsense," says Don.

**"If you have a bad knee, now is the time to have it replaced. Now is the time you need it. Why wait?"**


## Why Wright?

### What Makes Wright's Medial-Pivot Knee Different From Other Companies' Knees?

The research, development, engineering, and manufacturing that resulted in the ADVANCE® Medial-Pivot Knee is unique and complex. The design was developed in conjunction with top knee surgeons in the U.S. when one simple questions was asked: How can we design the best knee implant on the market, one that will most closely mimic the natural motion a natural knee?

Most total knee implants on the market were based on an outdated philosophy that the knee moves like a hinge; swinging only back and forth. But, the knee does not function that simply. A normal knee pivots on its medial (inner side) condyle. And, when the knee flexes, the lateral (outer) side rolls back while the medial side rotates in one place. This is precisely how the ADVANCE® Medial-Pivot Knee was designed and how it was named.

A picture (or animation, in this case) is worth a thousand words. To learn more, including why 80% of patients surveyed prefer Wright's knees over competitve implants, **visit www.wmt.com/totalknee.**

"Believe me, I put both knees to the test every day. And, I prefer the ADVANCE® Medial-Pivot."
Virginia Sage, bi-lateral knee recipient

# focus on oncology.

## Expandable, Limb Salvage Technology

Thanks to the perseverance of a mother determined to find a way for her daughter to keep her leg, Domonique Patton, a little girl from Michigan, has a bright and hopeful future ahead of her. A few years ago, this was hardly the case. When an x-ray revealed osteosarcoma (cancer) in the young girl's left leg and chemotherapy failed, the prognosis looked bleak for Dominique to avoid amputation.

The weekend before her daughter's amputation was scheduled, Domonique's mother, Leitia, spent hours desperately surfing the Internet. She came across a different treatment option, the REPIPHYSIS® Expandable Implant, the first bone replacement that does not require additional surgeries to lengthen the implant as the child's healthy limb grows. Instead, when the healthy limb grows, a 20-second, noninvasive procedure is performed to lengthen the prosthetic.

Leitia immediately told her daughter's physicians about the REPIPHYSIS® device. However, they were skeptical and preferred to move ahead with the amputation.

Leitia wouldn't accept this option and instead sought advice from Stephen Gitelis, MD, an orthopaedic oncologist in Chicago, IL. Dr. Gitelis told Leitia he could not promise that the expandable implant would work for her daughter, but said he was hopeful and willing to try the procedure.

Now, more than two years later, Domonique is thriving. She enjoys riding her bike and making play-dates with friends.

**the expansion process**

*The transmission ring is placed around the leg of the child.*

*During the 20-second activation, an electromagnetic field is transmitted to the implant, inducing heat in the locking mechanism.*

*The heat softens the polymer tube, which allows the implant to expand. Multiple activations may be necessary to achieve desired leg length.*

"It's scary to think that, if not for the REPIPHYSIS® Expandable Implant, I might have had to tell my little girl she may never ride her bike again.

We are so blessed to have found this option. By sharing our story, we hope to help people realize that sometimes miracles are possible."

Leitia Patton
mother of a daughter
*successfully treated with REPIPHYSIS® Implant*



## Why Wright?

### Why Does Wright Staff A Customs Department?

For over 23 years, Wright has perfected techniques to customize an array of implants. The vast majority of custom orders are for young patients who have lost bone as a result of cancer, requiring the use of a limb-sparing product. For these patients, timing is critical. Through skill and dedication, Wright's Customs Team can execute a custom order from design to production in as quickly as a few days. In 2005, over 120 custom implants were produced with the greatest compassion and care.

"It's awesome to know you are helping somebody live a better life."
Raines Sojourner, Wright Customs Team member of 21 years

## financial summary: table of contents

## Executive Overview

***Company Description***. We are a global orthopaedic medical device company specializing in the design, manufacture and marketing of reconstructive joint devices and biologics products. Reconstructive joint devices are used to replace knee, hip and other joints that have deteriorated through disease or injury. Biologics are used to replace damaged or diseased bone, to stimulate bone growth, and to provide other biological solutions for surgeons and their patients. We have been in business for over 50 years and have built a well-known and respected brand name and strong relationships with orthopaedic surgeons.

Our corporate headquarters and U.S. operations are located in Arlington, Tennessee, where we conduct our domestic research and development, manufacturing, warehousing, and administrative activities. Outside the U.S., we have research and development, manufacturing, and administrative facilities in Toulon, France; research, distribution and administrative facilities in Milan, Italy; and sales and distribution offices in Canada, Japan and throughout Europe. We market our products in over 60 countries through a global distribution system that consists of a sales force of approximately 750 individuals who promote our products to orthopaedic surgeons and hospitals. At the end of 2005, we have approximately 320 exclusive independent distributors and sales associates in the U.S., and approximately 430 sales representatives internationally who are employed through a combination of our stocking distribution partners and direct sales offices.

***Company History***. We were incorporated in November 1999 as a Delaware corporation, and had no operations until December 7, 1999, when we were reorganized by an investment group through the acquisition of our predecessor company, Wright Medical Technology, Inc. This transaction represented a recapitalization of our predecessor company. On December 22, 1999, we acquired Cremascoli Ortho Holding, S.A., an orthopaedic medical device company headquartered in Toulon, France. In 2001, we completed our IPO of 7,500,000 shares of common stock, which generated $84.8 million in net proceeds. In 2002, we completed a secondary offering of 3,450,000 shares of common stock which generated $49.5 million in net proceeds.

***Principal Products***. We primarily sell reconstructive joint devices and biologics products. Our reconstructive joint device sales are derived from three primary product lines: knees and hips, collectively referred to as our reconstructive large joint business, and extremities. Our biologics sales are derived from 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 biologics product lines.

Our hip joint reconstruction product portfolio provides offerings in the areas of bone-conserving implants, total hip reconstruction, revision replacement implants, and limb preservation. Our hip joint products include the CONSERVE® family of products, the PROFEMUR® Hip System, the LINEAGE® Acetabular System, the ANCA-FIT™ Hip System, and the PERFECTA® Hip System.

Our biologics products focus on biological musculoskeletal repair and include synthetic and human tissue-based materials. Our principal biologics products include the GRAFTJACKET® soft tissue repair and containment membranes, the ALLOMATRIX® line of injectable tissue-based bone graft substitutes, the OSTEOSET® synthetic bone graft substitute, the MIIG® family of minimally-invasive injectable synthetic bone grafts, and in certain of our international markets, the ADCON® Gel anti-adhesion product.

We offer extremity products for the hand, wrist, elbow, shoulder, foot and ankle in a number of markets worldwide. Our principal extremity products include the EVOLVE® Modular Radial Head device, the CHARLOTTE™ Foot and Ankle System, the LOCON-T® and LOCON™ VLS Distal Radius Plating Systems, and the MICRONAIL™ Intramedullary Wrist Fracture Repair System. We also sell the Swanson™ line of finger and toe joint replacement products and the ORTHOSPHERE® Carpometacarpal Implant for repair of the basal thumb joint.

Our knee reconstruction products position us well in the areas of total knee reconstruction, revision replacement implants, and limb preservation products. Our principal knee products include the ADVANCE® Knee System and the ADVANCE® Unicompartmental Knee System.

***Significant Business Developments***. Net sales grew 7.3% in 2005, totaling $319.1 million, compared to $297.5 million in 2004. Our success is attributable to our focus on the high growth sectors of the orthopaedic industry, such as advanced bearing surfaces, modular necks and bone conserving implants within the hip market. Our hip, knee and extremity product lines contributed significantly to our performance in 2005, achieving 10%, 8%, and 11% growth rates, respectively.

During 2005, our domestic biologics business declined by approximately 2% year-over-year. This decline was driven by the continued downward trend in sales of our DBM containing ALLOMATRIX® family of products due to competitive pressures in the mature market for DBM containing products. We anticipate that domestic sales of these products will continue to decline in 2006; however, we expect that these declines will be offset by sales growth of our GRAFTJACKET® soft tissue repair and containment membranes.

During 2005, our international sales increased by approximately 4% as compared to 2004. This slower rate of growth is attributable to our markets in France and Italy, both of which declined year-over-year. These declines began in the fourth quarter of 2004 as a result of the transition of certain management and distribution personnel in Southern Europe. We anticipate that sales in France and Italy will continue to decline year-over-year in the first half of 2006. However, we believe that sales in these markets will grow in the latter half of 2006 as the personnel now in place successfully complete this transitional period. Sales in our other international markets increased by 17% in total during 2005 as compared to prior year.

In mid-February 2005, we launched our internally-developed CHARLOTTE™ Foot and Ankle System and transitioned our foot and ankle business from a line of products supplied by a third party vendor pursuant to a distribution agreement that expired in the first quarter of 2005. The CHARLOTTE™ Foot and Ankle System offers a complete range of options for the most common foot and ankle surgical needs and includes six products that feature advanced design elements for simplicity, versatility, and high performance. During the fourth quarter of 2004, we incurred approximately $2.9 million of costs as a result of this transition to write down our distributed foot and ankle implant inventory to its estimated net realizable value and accelerated depreciation on the related surgical instrumentation. The success of our CHARLOTTE™ Foot and Ankle system contributed significantly to the success of our extremity product line in 2005.

In June 2005, our premarket approval (PMA) application with the United States Food and Drug Administration (FDA) for our ADCON® Gel product was withdrawn by management. Based on the progress of the review to date, management determined that in order to adequately address all of the requests made by the FDA in connection with their review of this application, withdrawal of the filing at this time was appropriate. Management is evaluating whether to continue to pursue re-submission for this product. If re-submitted, there can be no assurance that the FDA will accept another submission for filing in a timely manner or at all.

In November 2005, we received marketing clearance from the FDA for our IGNITE® Bone Void Filler kits. This clearance was obtained based on satisfaction of the FDA's requirements pursuant to a 510(k) premarket notification process that began with our submission of a 510(k). This submission was in response to the FDA's clarification to all known manufacturers of DBM-containing products including us, that such products should be regulated under the medical device premarket notification provisions of the Food, Drug, and Cosmetic Act. As of December 31, 2005, all of the Company's DBM-containing products currently produced and sold in the U.S. have received regulatory clearance.

***Significant Industry Factors***. Our industry is impacted by numerous competitive, regulatory and other significant factors. The growth of our business relies on our ability to continue to develop new products and innovative technologies, obtain regulatory clearance and compliance for our products, protect the proprietary technology of our products and our manufacturing processes, manufacture our products cost-effectively, respond to competitive pressures specific to each of our geographic markets, including our ability to enforce non-compete agreements, and successfully market and distribute our products in a profitable manner. We, and the entire industry, are subject to extensive governmental regulation, primarily by the FDA. Failure to comply with regulatory requirements could have a material adverse effect on our business. Additionally, our industry is highly competitive and has recently experienced increased pricing pressures, specifically in the areas of reconstructive joints and biologic bone repair products. We devote significant resources to assessing and analyzing competitive, regulatory and economic risks and opportunities. A detailed discussion of these and other factors is provided in Item 1A of this report.

### Net Sales and Expense Components

***Net sales***. We derive our net sales primarily from the sale of reconstructive joint devices and biologics products. An overview of our principal product lines is provided in "Executive Overview."

***Cost of sales***. Our cost of sales consists primarily of direct labor, allocated manufacturing overhead, raw materials and components, charges incurred for excess and obsolete inventories, royalty expenses associated with licensing technologies used in our products or processes, and certain other period expenses.

***Selling, general and administrative***. Our selling, general and administrative expenses consist primarily of salaries, sales commissions, royalty and consulting expenses associated with our medical advisors, marketing costs, facility costs, legal costs, other general business and administrative expenses, and depreciation expense associated with surgical instruments required by surgeons to use when implanting our products.

***Research and development***. Research and development expense includes costs associated with the design, development, testing, deployment, enhancement and regulatory approval of our products.

***Amortization of intangible assets***. Our intangible assets consist of purchased intangibles related to completed technology, distribution channels and trademarks primarily resulting from our 1999 acquisition of Cremascoli, as well as distribution and product licenses, and non-compete agreements. We amortize intangible assets over periods ranging from 1 to 15 years.

***Stock-based expense***. We incur non-cash stock-based expenses as a result of the amortization of non-cash deferred compensation that is recorded in accordance with Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees.* This deferred compensation resulted following the issuance of stock options to employees and the sale of equity securities prior to the completion of our IPO when the estimated fair value of the securities was deemed, for financial reporting purposes, to have exceeded their respective exercise or sales price. Additionally, for stock-based incentives granted to consultants, we defer and amortize the fair value of such grants as calculated pursuant to Statement of Financial Accounting Standards (SFAS) No. 123.

***Accounting for Stock-Based Compensation***. Deferred compensation is amortized on a straight-line basis over the respective vesting periods of the stock-based incentives, which is generally four years, and we immediately expense all non-cash stock-based compensation associated with the issuance of equity where no vesting restrictions apply.

In December 2004, the FASB issued SFAS No. 123 (Revised 2004), *Share Based Payment* (SFAS No. 123R), which requires the recognition of compensation expense for the fair value of share-based transactions. The fair value must be determined as of the date of grant using a valuation model such as Black-Scholes or a lattice model. The resulting compensation will be recognized over the service period. In April 2005, the SEC amended Rule 4-01(a) of Regulation S-X regarding the compliance date for SFAS No. 123R. This amendment modified the effective date of SFAS No. 123R, requiring adoption of this standard on the first interim or annual reporting period of the first fiscal year beginning on or after June 15, 2005. Accordingly, we adopted SFAS No. 123R effective January 1, 2006. Although management's evaluation of SFAS No. 123R is not complete, we estimate that the amount of non-cash stock-based compensation that we will record in 2006 pursuant to the adoption of SFAS No. 123R will be significant The effect on our historical results of operations of expensing the fair value of stock options using the Black-Scholes model and the provisions of SFAS No. 123 is presented in Note 2 to our consolidated financial statements in Item 8 of this report.

***Interest (income) expense, net***. Interest (income) expense, net, consists primarily of interest on borrowings outstanding under our senior credit facility, capital lease agreements, and certain of our factoring agreements, as well as non-cash expenses associated with the amortization of deferred financing costs resulting from the origination of our senior credit facility. These expenses are offset by income generated by our invested cash balances and investments in marketable securities.

***Provision for income taxes***. We record provisions for income taxes on earnings generated by both our domestic and international operations. Historically, our effective tax rates have varied from our statutory tax rates primarily due to research and development credits and changes in estimates related to our valuation allowances recorded against our net deferred tax assets.

## Results of Operations

**Comparison of the year ended December 31, 2005 to the year ended December 31, 2004**

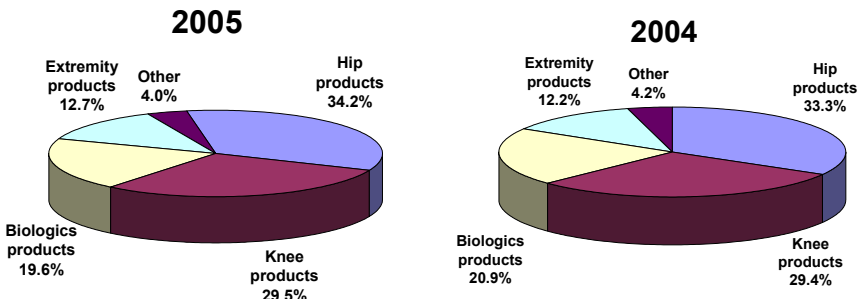
The following table sets forth, for the periods indicated, our results of operations expressed as dollar amounts (in thousands) and as percentages of net sales:

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | 2005 | | 2004 | |
| | Amount | % of Sales | Amount | % of Sales |
| Net sales | $ 319,137 | 100.0 % | $ 297,539 | 100.0 % |
| Cost of sales | 91,740 | 28.7 % | 84,183 | 28.3 % |
| Gross profit | 227,397 | 71.3 % | 213,356 | 71.7 % |
| Operating expenses: | | | | |
| Selling, general and administrative | 166,916 | 52.3 % | 151,144 | 50.8 % |
| Research and development | 22,283 | 7.0 % | 18,421 | 6.2 % |
| Amortization of intangible assets | 4,250 | 1.3 % | 3,889 | 1.3 % |
| Stock-based expense | 467 | 0.1 % | 1,489 | 0.5 % |
| Total operating expenses | 193,916 | 60.8 % | 174,943 | 58.8 % |
| Operating income | 33,481 | 10.5 % | 38,413 | 12.9 % |
| Interest (income) expense, net | (176) | (0.1)% | 1,064 | 0.4 % |
| Other expense (income), net | 237 | 0.1 % | (74) | 0.0 % |
| Income before income taxes | 33,420 | 10.5 % | 37,423 | 12.6 % |
| Provision for income taxes | 12,355 | 3.9 % | 13,401 | 4.5 % |
| Net income | $ 21,065 | 6.6 % | $ 24,022 | 8.1 % |

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

| | Year Ended December 31, 2005 | Year Ended December 31, 2004 | % Change |
|---|---|---|---|
| Hip products | $ 109,267 | $ 99,133 | 10.2 % |
| Knee products | 94,073 | 87,408 | 7.6 % |
| Biologics products | 62,358 | 62,070 | 0.5 % |
| Extremity products | 40,594 | 36,433 | 11.4 % |
| Other | 12,845 | 12,495 | 2.8 % |
| Total net sales | $ 319,137 | $ 297,539 | 7.3 % |

The following graphs illustrate our product line sales as a percentage of total net sales for the years ended December 31, 2005 and 2004:



***Net sales***. Our net sales growth in 2005 was primarily attributable to the success of our domestic reconstructive joint business, as our domestic hip, extremity and knee product lines grew by 18%, 12%, and 11%, respectively. Domestic net sales totaled $197.5 million in 2005 and $180.4 million in 2004, representing approximately 62% and 61% of total net sales in 2005 and 2004, respectively, and growth of 10%. International net sales totaled $121.6 million in 2005, a 4% increase as compared to net sales of $117.2 million in 2004. This increase in international sales is attributable to continued growth in our Asian markets, which was partially offset by declines in our Italian and French markets due to the transition of management and distribution personnel in Southern Europe.

Our hip product sales totaled $109.3 million in 2005, representing a 10% increase. Growth in our hip business in 2005 was primarily driven by our domestic markets, where total hip unit sales grew 13% as compared to 2004, reflecting the success of our CONSERVE® Total Implant with BFH™ Technology and our PROFEMUR® line of primary stems featuring our innovative neck modularity. Additionally, we have continued to note favorable shifts in our sales mix to premium priced hard bearing procedures, which include our ceramic-on-ceramic and metal-on-metal products, which further contributed to our domestic growth. In our international markets, hips sales increased by 2% to $52.0 million, as increased sales, primarily in Japan, were mostly offset by declines in Italy.

Our extremity product sales increased to $40.6 million in 2005, representing growth of 11% over 2004, which is mainly attributable to increased unit sales of our EVOLVE® Modular Radial Head System and the successful mid-February 2005 launch of our CHARLOTTE™ Foot and Ankle system. Further contributing to our year-over-year growth were increased unit sales of our MICRONAIL™ intramedullary wrist fracture repair system and our LOCON-T® and LOCON™ VLS Distal Radius Plating Systems.

Sales of our knee products totaled $94.1 million in 2005, representing growth of 8% as compared to 2004. This increase was primarily driven by increased unit sales of our ADVANCE® knee systems due to enhanced minimally invasive surgery (MIS) instrumentation and broader acceptance of our ADVANCE® Double-High tibial insert. International knee sales growth in Asia and certain European markets was partially offset by declines in France and Italy.
Sales of our biologics products in 2005 totaled $62.4 million, and were relatively flat compared to prior year. The continued growth of our GRAFTJACKET® soft tissue repair and containment membranes in the U.S., as well as increased sales in Asia, were offset by declines of our DBM containing products in our domestic markets.

As we look ahead in 2006, we anticipate continued growth within our reconstructive joint business. In our knee business, we look forward to continuing success as our minimally invasive surgical instrumentation continues to gain acceptance in the U.S. In our hip business, we anticipate that the strength of our hip product portfolio, which consists of our innovative bone-conserving implants, advanced bearing surfaces and modular neck technology, will lead to continued success in the market. Our extremity business should continue to strengthen, driven mostly by our CHARLOTTE™ foot and ankle system, our EVOLVE® Modular Radial Head system and our wrist fracture repair products. Within biologics, we expect sales of our GRAFTJACKET® tissue repair and containment membranes to continue to expand.

***Cost of sales***. In 2005, our cost of sales as a percentage of net sales increased to 28.7% as compared to 28.3% in 2004. Cost of sales in 2005 included charges of approximately $1.5 million to write down inventory to its net realizable value due to the termination of an agreement to distribute certain third party spinal products in Europe. Cost of sales in 2004 included charges of approximately $2.4 million to write down certain foot and ankle inventory to its net realizable value as a result of the transition to our CHARLOTTE™ foot and ankle system. The increase in cost of sales as a percentage of net sales is attributable to increased levels of fixed manufacturing costs and distribution costs, as well as shifts in our product line sales. Our cost of sales and corresponding gross profit percentages can be expected to fluctuate in future periods depending upon changes in our product sales mix and prices, distribution channels and geographies, manufacturing yields, period expenses and levels of production volume.

***Selling, general and administrative***. Our selling, general and administrative expenses as a percentage of net sales totaled 52.3% in 2005, a 1.5 percentage point increase from 50.8% in 2004. This increase is primarily attributable to severance charges of approximately $1.6 million incurred during 2005 related to the transition of management in our U.S. and European operations, charges of approximately $1.5 million related to a European distributor transition and the related legal dispute, increased investments in sales and marketing initiatives, and higher levels of legal fees. These increases were partially offset by the favorable resolution in the second quarter of 2005 of two liabilities assumed as part of our December 1999 acquisition of Cremascoli, lower expenses related to compliance with Section 404 of the Sarbanes-Oxley Act of 2002, reduced insurance costs, and the 2004 expenses related to our limited market withdrawal of certain CONSERVE® hip components and our foot and ankle product line transition.

We anticipate that our selling, general and administrative expenses will increase in absolute dollars to the extent that any additional growth in net sales results in increases in sales commissions and royalty expense associated with those sales and requires us to expand our infrastructure. Further, in the near term, we anticipate that these expenses will increase as a percentage of net sales as we make strategic investments in order to grow our business, and as we record non-cash stock-based compensation pursuant to SFAS No. 123R.

***Research and development***. Our investment in research and development activities represented approximately 7.0% of net sales in 2005, as compared to 6.2% in 2004. The increase was driven by elevated levels of investments in product development initiatives and increases in clinical and regulatory spending. Our key product launches in 2005 included our CHARLOTTE™ Foot and Ankle System and our CONSERVE® BFH Advance Metal.

For 2006, we anticipate that our research and development expenditures will increase as a percentage of net sales and in absolute dollars as we continue to increase our investment in product development initiatives and clinical studies to support regulatory approvals and provide expanded proof of the efficacy of our products, and as we record non-cash stock-based compensation pursuant to SFAS No. 123R.

***Amortization of intangible assets***. Non-cash charges associated with amortization of intangible assets totaled $4.3 million in 2005 versus $3.9 million in 2004. Based on the intangible assets held at December 31, 2005, we expect to amortize approximately $4.0 million in 2006, $3.0 million in 2007, $2.7 million in 2008, $2.4 million in 2009 and $350,000 in 2010.

***Stock-based expense.*** We recognized $467,000 and $1.5 million of non-cash stock-based expense during 2005 and 2004, respectively. This decrease is due to lower levels of amortization of deferred compensation related to options issued prior to our initial public offering in 2001.

***Interest (income) expense, net.*** Interest (income) expense, net, consists of interest expense of approximately $1.9 million during both 2005 and 2004, primarily from borrowings under our senior credit facility, capital lease agreements, and certain of our factoring agreements, offset by interest income of approximately $2.0 million and $850,000 during 2005 and 2004, respectively, generated by our invested cash balances and investments in marketable securities. The increase in interest income is attributable to our investments in marketable securities during 2005. These investments are discussed further in Note 2 to our consolidated financial statements in Item 8 of this report.

***Provision for income taxes.*** We recorded tax provisions of $12.4 million and $13.4 million in 2005 and 2004, respectively. Our effective tax rate for 2005 and 2004 was approximately 37% and 36%, respectively, which reflects the impact of research and development credits, changes in estimates related to the valuation allowances recorded against our deferred tax assets and, in 2005, the impact of the domestic manufacturers' deduction included within the American Jobs Creation Act of 2004.

We expect our 2006 effective tax rate to be significantly higher than our historical effective tax rates as a result of the expense we will be required to record under the provisions of SFAS 123R. A significant portion of the non-cash stock-based compensation that we will recognize may not be deductible under U.S. and foreign tax regulations. We cannot reasonably estimate our overall effective tax rate for 2006, as we are unable to reasonably estimate the amount of future stock option grants and the related expense that will ultimately be deductible for tax purposes.

**Comparison of the year ended December 31, 2004 to the year ended December 31, 2003**

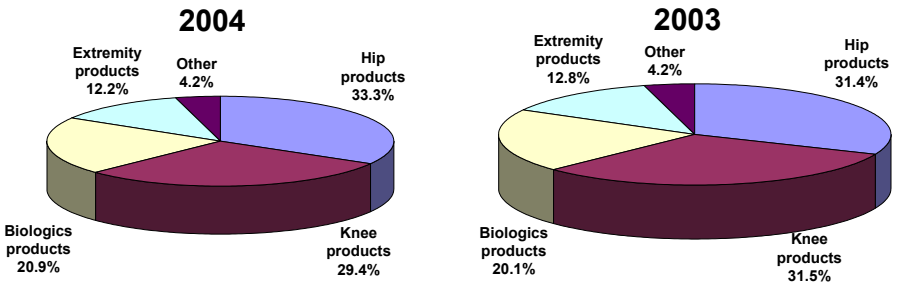
The following table sets forth, for the periods indicated, our results of operations expressed as dollar amounts (in thousands) and as percentages of net sales:

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | 2004 | | 2003 | |
| | Amount | % of Sales | Amount | % of Sales |
| Net sales | $ 297,539 | 100.0 % | $ 248,932 | 100.0 % |
| Cost of sales | 84,183 | 28.3 % | 67,815 | 27.2 % |
| Gross profit | 213,356 | 71.7 % | 181,117 | 72.8 % |
| Operating expenses: | | | | |
| Selling, general and administrative | 151,144 | 50.8 % | 127,612 | 51.3 % |
| Research and development | 18,421 | 6.2 % | 16,151 | 6.5 % |
| Amortization of intangible assets | 3,889 | 1.3 % | 3,562 | 1.4 % |
| Stock-based expense | 1,489 | 0.5 % | 2,068 | 0.8 % |
| Acquired in-process research and development costs | - | - | 4,558 | 1.8 % |
| Total operating expenses | 174,943 | 58.8 % | 153,951 | 61.8 % |
| Operating income | 38,413 | 12.9 % | 27,166 | 10.9 % |
| Interest expense, net | 1,064 | 0.4 % | 1,107 | 0.4 % |
| Other income, net | (74) | 0.0 % | (1,060) | (0.4)% |
| Income before income taxes | 37,423 | 12.6 % | 27,119 | 10.9 % |
| Provision for income taxes | 13,401 | 4.5 % | 9,722 | 3.9 % |
| Net income | $ 24,022 | 8.1 % | $ 17,397 | 7.0 % |

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

| | Year Ended December 31, 2004 | Year Ended December 31, 2003 | % Change |
|---|---|---|---|
| Hip products | $ 99,133 | $ 78,071 | 27.0 % |
| Knee products | 87,408 | 78,338 | 11.6 % |
| Biologics products | 62,070 | 50,056 | 24.0 % |
| Extremity products | 36,433 | 31,876 | 14.3 % |
| Other | 12,495 | 10,591 | 18.0 % |
| Total net sales | $ 297,539 | $ 248,932 | 19.5 % |

The following graphs illustrate our product line sales as a percentage of total net sales for the years ended December 31, 2004 and 2003:




***Net sales.*** Net sales growth in 2004 was attributable to increased sales across all of our principal product lines, with significant contributions from hips and biologics which grew by 27% and 24%, respectively, and solid growth in our extremity and knee business which grew by 14% and 12%, respectively. Geographically, our domestic net sales totaled $180.4 million in 2004 and $152.9 million in 2003, representing approximately 61% of total net sales in both years and growth of 18%. Our international net sales totaled $117.2 million in 2004, a 22% increase as compared to net sales of $96.1 million in 2003. Our 2004 international net sales included a favorable currency impact of approximately $8.1 million when compared to 2003 net sales, principally resulting from the 2004 performance of the euro against the U.S. dollar. Our international growth was primarily driven by increased sales in our European and Asian markets, with expansion across all product lines.

From a product line perspective, our net sales growth for 2004 was attributable to increases in sales across all of our principal product lines. For 2004, we experienced growth of 27%, 24%, 14% and 12%, in our hip, biologics, extremity, and knee product lines, respectively. Our most significant growth drivers in 2004 were our hip and biologics product lines. During 2004, our 27% hip sales growth was attributable primarily to success in domestic markets, specifically driven by our CONSERVE® Total Implant with BFH™ Technology and our PROFEMUR® line of primary stems featuring our innovative neck modularity. In our international markets, unit sales growth of our CONSERVE® Plus Resurfacing Implant and a favorable currency impact of $4 million both impacted the year over year sales increase. The growth of our biologics business in 2004 was primarily attributable to the continued favorable performance, in domestic markets, of our GRAFTJACKET® soft tissue repair and containment membranes combined with the performance of our ADCON® Gel product in international markets.

***Cost of sales.*** Cost of sales as a percentage of net sales increased to 28.3% in 2004 from 27.2% in 2003. Approximately 0.8 percentage points of this increase was attributable to $2.4 million of costs incurred during the fourth quarter of 2004 to write down certain foot and ankle implant inventory to its net realizable value as a result of the transition of this product line to our CHARLOTTE™ Foot and Ankle System. The remaining increase as a percentage of sales was primarily attributable to higher levels of charges incurred for excess and obsolete inventories.

***Operating expenses.*** Our total operating expenses decreased, as a percentage of net sales, by 3 percentage points to 58.8% in 2004. Operating expenses include selling, general and administrative expenses, research and development expenses, amortization of intangibles, stock-based expenses and, in 2003, acquired in-process research and development costs. The decrease in operating expenses was primarily driven by the 2003 charge of $4.6 million for in-process research and development. Further, our selling, general and administrative expenses as a percentage of net sales decreased by 0.5 percentage points, driven by lower royalty and commission expenses as a percentage of sales due to shifts in our geographic sales mix, which were partially offset by incremental corporate governance costs as well as charges associated with our limited market withdrawal of certain CONSERVE® hip components and our foot and ankle product line transition. Lower levels of stock-based expense also contributed to our year-over-year decrease in operating expenses as a percentage of net sales.

***In-process research and development cost.*** Upon consummation of our acquisition of certain ADCON® Gel technology assets from Gliatech Inc. in March 2003, we immediately recognized as expense approximately $4.6 million in costs representing the estimated fair value of acquired in-process research and development (IPRD) that had not yet reached technological feasibility and had no alternative future use. See Note 3 to our consolidated financial statements in Item 8 of this report.

We engaged an independent third party to conduct a valuation of the intangible assets acquired. The value was determined by estimating the costs to develop the acquired IPRD into commercially viable products, estimating the resulting net cash flows from this project, and discounting the net cash flows back to their present values. An additional discount was applied to take into account the uncertainty surrounding the successful development and commercialization of the acquired IPRD. The resulting net cash flows from the project were based on management's best estimates of revenue, cost of sales, research and development costs, selling, general and administrative costs, and income taxes from the project. A summary of the estimates used to calculate the net cash flows for the project is as follows:

| Project | Year net cash in-flows expected to begin | Discount rate including factor to account for uncertainty of success | Acquired IPRD |
|---|---|---|---|
| ADCON® Gel | 2004 | 32.3% | $ 4,558,000 |

ADCON® Gel products are designed to reduce adhesion formation following lumbar spine (ADCON®-L Gel) and peripheral tendon/nerve (ADCON®-T/N Gel) procedures, thus reducing or eliminating post-operative pain. Both ADCON®-L Gel and ADCON®-T/N Gel are commercially available internationally, but are currently not available for sale in the U.S. ADCON®-L Gel had previously received regulatory clearance from the FDA in 1998. In 2000, the FDA determined that the provisions of its Application Integrity Policy (AIP) would be applied to Gliatech due to violations of Good Clinical Practices in the conduct, analysis, and reporting of data specific to the U.S. Clinical Study of ADCON®-L Gel. In 2003, the FDA lifted the AIP status of Gliatech, which subsequently allowed us, as the new owner of the technology, to present the FDA with clinical data intended to support the return of ADCON®-L Gel to the U.S. market. However, in 2005, our PMA application with the FDA for our ADCON® Gel product was withdrawn by management. Management is considering whether to continue to pursue re-submission for this product. If re-submitted, there can be no assurance that the FDA will accept another submission for filing in a timely manner or at all.

We may use portions of our existing cash to continue to develop the acquired IPRD into commercially viable products. This development would consist primarily of the completion of all clinical evaluation testing activities and regulatory approvals that are necessary to establish the safety and efficacy of the products and to market them in the U.S. Bringing the acquired IPRD to market could also include testing the products for compatibility and interoperability with commercially viable products. Due to the history of the ADCON® Gel products with the FDA, we are unable to estimate the extent of research and development activities that will be necessary to develop these products into commercially viable products.

***Provision for income taxes***. Our effective tax rate for both 2004 and 2003 was approximately 36%, which reflects the impact of research and development credits and changes in estimates related to the valuation allowances recorded against our deferred tax assets.

### Seasonal Nature of Business

We traditionally experience lower sales volumes in the third quarter months than throughout the rest of the year as a result of the European holiday schedule. In addition, our first quarter selling, general and administrative expenses include additional expenses that we incur in connection with the annual meeting held by the American Academy of Orthopaedic Surgeons. This meeting, which is the largest orthopaedic meeting in the world, features the presentation of scientific papers and instructional courses for orthopaedic surgeons. During this 3-day event, we display our most recent and innovative products for these surgeons.

### Liquidity and Capital Resources

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

| | As of December 31, | |
|---|---|---|
| | 2005 | 2004 |
| Cash and cash equivalents | $ 51,277 | $ 83,470 |
| Short-term marketable securities | 25,000 | - |
| Working capital | 196,126 | 189,803 |
| Line of credit availability | 59,878 | 59,708 |

During 2005, we invested $25 million of our excess cash balance in short-term marketable debt securities in order to increase our rate of return, resulting in a decrease in our cash and cash equivalents. Specifically, our investments in marketable securities at December 31, 2005, are available for redemption through an auction process every 21 or 49 days from initial purchase. While these investments are not considered cash equivalents for financial reporting purposes, due to the short-term nature of these investments, we do not believe that these investments will have an impact on our overall liquidity position.

***Operating Activities***. Cash provided by operating activities totaled $5.3 million in the 2005, as compared to $37.4 million in 2004 and $40.1 million in 2003. The decrease in cash provided by operating activities in 2005 is primarily attributable to $25 million of cash invested in marketable securities and increased payments for estimated income taxes of approximately $8.8 million. Cash provided by operating activities in 2004 benefited from the profitability of our business and working capital management, which resulted primarily from improved collection of our outstanding receivables during 2004, which was offset by increased investments in new product inventory in order to prepare for anticipated product launches, as well as an increase of approximately $3.9 million for estimated tax payments.

***Investing Activities***. Our capital expenditures totaled approximately $30.4 million in 2005, $18.3 million in 2004, and $18.1 million in 2003. The increase in 2005 is primarily related to investments in minimally invasive surgical instrumentation for our hip and knee businesses. Our industry is capital intensive, particularly as it relates to surgical instrumentation. Historically, our capital expenditures have consisted of purchased manufacturing equipment, research and testing equipment, computer systems, office furniture and equipment, and surgical instruments. We expect to incur capital expenditures of approximately $30 million in total for 2006 for routine capital expenditures.

In 2003, in addition to our routine capital expenditures, we paid $7.8 million to complete the purchase of IPRD, tangible assets, and intangible assets from Gliatech, which were primarily related to the ADCON® Gel technology. We are continuously evaluating opportunities to purchase technology and other forms of intellectual property and are, therefore, unable to predict the timing of future purchases.

***Financing Activities***. During 2005, we made $5.0 million in scheduled payments related to borrowings under our senior credit facility and approximately $2.1 million in payments related to our long-term capital leases. These payments were offset by proceeds of $2.9 million from the issuance of common stock under our stock-based compensation plans. In addition, our operating subsidiary in Italy continues to factor portions of its accounts receivable balances under factoring

agreements, which are considered financing transactions for financial reporting purposes. The cash proceeds received from these factoring agreements, net of the amount of factored receivables collected, are reflected as cash flows from financing activities in our consolidated statements of cash flows. The proceeds received under these agreements in 2005, 2004, and 2003 totaled approximately $8.0 million, $10.7 million, and $4.7 million, respectively. These proceeds were offset by payments for factored receivables collected of approximately $9.2 million and $10.8 million in 2005 and 2004, respectively. We recorded obligations of $3.5 million and $5.2 million for the amount of receivables factored under these agreements as of December 31, 2005 and 2004, respectively, which are included within "Accrued expenses and other current liabilities" in our consolidated balance sheet.

In 2006, our debt payments will total $3.8 million based on the terms of our senior credit facility. Additionally, we will make continued payments under our long-term capital leases, including interest, of approximately $2.0 million in 2006. We anticipate that our factoring program in Italy will continue; however, the level and extent of the amounts factored under the agreement and the ultimate amount of proceeds received under the program cannot be predicted. Therefore, we are unable to predict the ultimate amount of proceeds that will be received in 2006 related to these factoring agreements.

***Contractual Cash Obligations***. At December 31, 2005, we had contractual cash obligations and commercial commitments as follows (in thousands):

| | Payments Due by Periods | | | | |
|---|---|---|---|---|---|
| | Total | 2006 | 2007-2008 | 2009 - 2010 | After 2010 |
| ***Amounts reflected in balance sheet:*** | | | | | |
| Notes payable | $ 3,750 | $ 3,750 | $ - | $ - | $ - |
| Capital lease obligations[1] | 3,858 | 2,008 | 1,578 | 266 | 6 |
| ***Amounts not reflected in balance sheet:*** | | | | | |
| Operating leases | 14,407 | 6,167 | 6,492 | 986 | 762 |
| Purchase obligations | 5,160 | 5,160 | - | - | - |
| Royalty and consulting agreements | 6,317 | 3,369 | 861 | 760 | 1,327 |
| Total contractual cash obligations | $ 33,492 | $ 20,454 | $ 8,931 | $ 2,012 | $ 2,095 |

[1] Payments include amounts representing interest

Our senior credit facility, which we entered into in August 2001, has a five-year term and consists of $20 million in term loans, with an unpaid balance of approximately $3.8 million at December 31, 2005, and a revolving loan facility of up to $60 million. Borrowings under the senior credit facility are guaranteed by all of our subsidiaries and are collateralized by all of the assets of Wright Medical Technology, Inc., our wholly-owned subsidiary. The credit facility contains customary covenants including, among other things, restrictions on our ability to pay cash dividends, prepay debt, incur additional debt and sell assets. The credit facility also requires us to maintain certain financial covenants, including a specified consolidated leverage (or debt-to-equity) ratio and a specified consolidated fixed charge coverage ratio. In the event that we violate any covenants, we could be required to repay the remaining balance of the debt. Additionally, should we be required to repay the loan before its scheduled maturity, we would incur a charge to operating income for unamortized financing costs. At our option, borrowings under the credit facility bear interest either at a rate equal to a fixed base rate plus a spread of 0.75% to 1.25% or at a rate equal to an adjusted LIBOR plus a spread of 1.75% to 2.25%, depending on our consolidated leverage ratio, with a current annual rate of 5.7%. The amounts reflected in the table above for capital lease obligations represent future minimum lease payments under our capital lease agreements which are primarily for certain property and equipment. The present value of the minimum lease payments are recorded in our balance sheet at December 31, 2005. The minimum lease payments related to these leases are discussed further in Note 8 to our consolidated financial statements contained in Item 8 of this report.

The amounts reflected in the table above for operating leases represent future minimum lease payments under noncancellable operating leases primarily for certain equipment and office space. Portions of these payments are denominated in foreign currencies and were translated in the table above based on their respective U.S. dollar exchange rates at December 31, 2005. These future payments are subject to foreign currency exchange rate risk. In accordance with accounting principles generally accepted in the U.S., our operating leases are not recognized in our consolidated balance sheet; however, the minimum lease payments related to these agreements are disclosed in Note 15 to our consolidated financial statements contained in Item 8 of this report.

Our purchase obligations reflected in the table above consist of minimum purchase obligations related to certain supply agreements. The royalty and consulting agreements in the above table represent minimum payments to consultants that are contingent upon future services. Portions of these payments are denominated in foreign currencies and were translated in the table above based on their respective U.S. dollar exchange rates at December 31, 2005. These future payments are subject to foreign currency exchange rate risk. Our purchase obligations and royalty and consulting agreements are disclosed in Note 15 to our consolidated financial statements contained in Item 8 of this report.

In addition to the contractual cash obligations discussed above, all of our domestic sales and a portion of our international sales are subject to commissions based on net sales, and a substantial portion of our global sales are subject to other royalties earned based on product sales. Further, under our factoring agreement in Italy, our liability for cash proceeds received of $3.5 million discussed in "Financing Activities" may be subject to repayment upon 15 days notice. None of these amounts are included in the table above.

***Other Liquidity Information***. We have funded our cash needs since 2000 through various equity and debt issuances and through cash flow from operations.

In 2001, we completed our IPO of 7,500,000 shares of common stock which generated $84.8 million in net proceeds. In 2002, we completed a secondary offering of 3,450,000 shares of common stock which generated $49.5 million in net proceeds.

In 2006, our senior credit facility will expire and it is our current intent to replace this credit facility with a new facility including a credit line equal to or greater than our current $60 million credit line. There can be no assurance that we will ultimately be able to replace our current credit facility with a new facility which includes a credit line of this level.

Although it is difficult for us to predict our future liquidity requirements, we believe that our current cash balance of approximately $51.3 million, our marketable securities balance of $25.0 million, and our expected cash flow from our 2006 operations will be sufficient for the foreseeable future to fund our working capital requirements and operations, permit anticipated capital expenditures in 2006 of approximately $30 million, meet our contractual cash obligations in 2006, and fund any potential expansion of our current facilities or the construction of new facilities.

## Critical Accounting Estimates

All of our significant accounting policies and estimates are described in Note 2 to our consolidated financial statements contained in Item 8 of this report. However, certain of our more critical accounting estimates require the application of significant judgment by management in selecting the appropriate assumptions in determining the estimate. By their nature, these judgments are subject to an inherent degree of uncertainty. We develop these judgments based on our historical experience, terms of existing contracts, our observance of trends in the industry, information provided by our customers, and information available from other outside sources, as appropriate. Different, reasonable estimates could have been used in the current period. Additionally, changes in accounting estimates are reasonably likely to occur from period to period. Both of these factors could have a material impact on the presentation of our financial condition, changes in financial condition or results of operations.

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

***Revenue recognition***. Our revenues are generated through two types of customers, hospitals and stocking distributors, with the majority of our revenue derived from sales to hospitals. Our products are sold through a network of independent sales representatives in the US and by a combination of employee sales representatives, independent sales representatives, and stocking distributors outside the U.S. We record revenues from sales to hospitals when the hospital takes title to the product, which is when the product is surgically implanted in a patient and a purchase order is received from the hospital. We view the receipt of a purchase order as the evidence of customer acceptance of the product.

We record revenues from sales to our stocking distributors at the time the product is shipped to the distributor. Our stocking distributors, who sell the products to their customers, take title to the products and assume all risks of ownership. Our distributors are obligated to pay us within specified terms regardless of when, if ever, they sell the products. In general, our distributors do not have any rights of return or exchange; however, in limited situations we have repurchase agreements with certain stocking distributors. Those certain agreements require us to repurchase a specified percentage of the inventory purchased by the distributor within a specified period of time prior to the expiration of the contract. During those specified periods, we defer the applicable percentage of the sales. Approximately $170,000 and $90,000 of deferred revenue related to these types of agreements was recorded at December 31, 2005 and 2004, respectively.

We must make estimates of potential future product returns related to current period product revenue. To do so, we analyze our historical experience related to product returns when evaluating the adequacy of the allowance for sales returns. Judgment must be used and estimates made in connection with establishing the allowance for product returns in any accounting period. Our allowances for product returns of approximately $430,000 and $400,000 are included as a reduction of accounts receivable at December 31, 2005 and 2004, respectively. Should actual future returns vary significantly from our historical averages, our operating results could be affected.

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

The majority of the Company's receivables are from hospitals, many of which are government funded. Accordingly, the Company's collection history with this class of customer has been favorable. Historically, the Company has experienced minimal bad debts from its hospital customers and more significant bad debts from certain international distributors, typically as a result of specific financial difficulty or geo-political factors. The Company writes off receivables when it determines that the receivables are uncollectible, typically upon customer bankruptcy or the customer's non-response to collection efforts.

We believe that the amount included in our allowance for doubtful accounts has been a historically accurate estimate of the amount of accounts receivable that are ultimately collected. While we believe that our allowance for doubtful accounts is adequate, the financial condition of our customers and the geo-political factors that impact reimbursement under individual countries' healthcare systems can change rapidly and as such, additional allowances may be required in future periods. Our accounts receivable balance for both 2005 and 2004 was $61.7 million, net of allowances for doubtful accounts of $2.0 million and $1.8 million, at December 31, 2005 and 2004, respectively.

***Excess and obsolete inventories***. We value our inventory at the lower of the actual cost to purchase and/or manufacture the inventory or its net realizable value. We regularly review inventory quantities on hand for excess and obsolete inventory and, when circumstances indicate, we incur charges to write down inventories to their net realizable value. Our review of inventory for excess and obsolete quantities is based primarily on our estimated

forecast of product demand and production requirements for the next twenty-four months. A significant decrease in demand could result in an increase in the amount of excess inventory quantities on hand. Additionally, our industry is characterized by regular new product development that could result in an increase in the amount of obsolete inventory quantities on hand due to cannibalization of existing products. Also, our estimates of future product demand may prove to be inaccurate, in which case we may be required to incur charges for excess and obsolete inventory. In the future, if additional inventory write-downs are required, we would recognize additional cost of goods sold at the time of such determination. Regardless of changes in our estimates of future product demand, we do not increase the value of our inventory above its adjusted cost basis. Therefore, although we make every effort to ensure the accuracy of our forecasts of future product demand, significant unanticipated decreases in demand or technological developments could have a significant impact on the value of our inventory and our reported operating results.

Charges incurred for excess and obsolete inventory were $6.9 million, $5.8 million and $2.6 million for the years ended December 31, 2005, 2004 and 2003, respectively. In 2004, charges incurred for excess and obsolete inventory included $2.4 million recorded to write down certain foot and ankle implant inventory to its net realizable value as a result of our transition to our CHARLOTTE™ Foot and Ankle System. In 2005, we incurred approximately $1.5 million in charges within cost of sales to write down inventory to its net realizable value due to the termination of an agreement to distribute certain third party spinal products in Europe.

***Goodwill and long-lived assets***. We have approximately $7.8 million of goodwill recorded as a result of acquisition of businesses. Goodwill is tested for impairment annually, or more frequently if changes in circumstances or the occurrence of events suggest that impairment exists. Based on our single business approach to decision-making, planning, and resource allocation, we have determined that we have only one reporting unit for purposes of evaluating goodwill for impairment. The annual evaluation of goodwill impairment requires the use of estimates and assumptions to determine the fair value of our reporting unit using projections of future cash flows. Our estimates of future sales growth rates and operating margin can significantly affect the outcome of the impairment test. We performed our annual impairment test during the fourth quarter of 2005 and determined that the fair value of our reporting unit exceeded its carrying value and, therefore, no impairment charge was necessary. Our business is capital intensive, particularly as it relates to surgical instrumentation. We depreciate our property, plant and equipment and amortize our intangible assets based upon our estimate of the respective asset's useful life. Our estimate of the useful life of an asset requires us to make judgments about future events, such as product life cycles, new product development, product cannibalization and technological obsolescence, as well as other competitive factors beyond our control. We account for the impairment of long-lived assets in accordance SFAS No. 144.

***Accounting for the Impairment or Disposal of Long-Lived Assets***. Accordingly, we evaluate impairments of our property, plant and equipment based upon an analysis of estimated undiscounted future cash flows. If we determine that a change is required in the useful life of an asset, future depreciation/amortization is adjusted accordingly. Alternatively, should we determine that an asset has been impaired, an adjustment would be charged to income based on its fair market value, or discounted cash flows if the fair market value is not readily determinable, reducing income in that period.

***Product liability claims***. Periodically, claims arise involving the use of our products. We make provisions for claims specifically identified for which we believe the likelihood of an unfavorable outcome is probable and an estimate of the amount of loss has been developed. We have recorded at least the minimum estimated liability related to those claims where a range of loss has been established. As additional information becomes available, we reassess the estimated liability related to our pending claims and make revisions as necessary. Future revisions in our estimates of the liability could materially impact our results of operation and financial position. We maintain insurance coverage that limits the severity of any single claim as well as total amounts incurred per policy year, and we believe our insurance coverage is adequate. We use the best information available to us in determining the level of accrued product liabilities and we believe our accruals are adequate. During 2004, we recorded $500,000 in product liability reserves for probable losses following our announcement of a voluntary market withdrawal of a limited number of metal acetabular hip cups intended for use in our CONSERVE® hip systems.

Management developed this estimate and believes that the amount recorded is appropriate based on assumptions with respect to estimated patient claims related to the market withdrawal and the acceptance of such claims by our insurer. The nature of a market withdrawal and the associated claims are such that the claims will occur over an extended period of time. Our estimate includes an assumption for unasserted claims based on management's industry experience with similar circumstances. While we believe that the amount recorded related to the market withdrawal is appropriate, it is possible that changes in assumptions related to potential claims or insurance coverage could have an adverse effect on our estimate. Our accrual for product liability claims was approximately $850,000 and $1.0 million at December 31, 2005 and 2004, respectively.

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

We have recorded valuation allowances of $6.0 million and $6.8 million as of December 31, 2005 and 2004, respectively, due to uncertainties related to our ability to realize, before expiration, some of our deferred tax assets for both U.S. and foreign income tax purposes. These deferred tax assets primarily consist of the carry forward of certain net operating losses and general business tax credits.

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

### Impact of Recently Issued Accounting Pronouncements

In November 2004, the FASB issued SFAS No. 151, *Inventory Costs - An Amendment of ARB No. 43, Chapter 4* (SFAS No. 151). SFAS No. 151 will no longer allow companies to capitalize inventory costs on their balance sheet when the production defect rate varies significantly from the expected rate. All abnormal freight, handling and material waste will be treated as period expenses. Additionally, SFAS No. 151 requires that a facility's fixed production overhead be charged to inventory based on a range of "normal" capacity. If the production level is abnormally low, unallocated overhead should be charged to current period expense. SFAS No. 151 is required to be adopted for annual periods beginning after June 15, 2005; accordingly, we will adopt SFAS No. 151 effective January 1, 2006. We do not believe that the impact of this standard will have a material impact on our results of operations or financial statements.

In December 2004, the FASB issued SFAS No. 123R, which requires the recognition of compensation expense for the fair value of share-based transactions. In April 2005, the SEC amended Rule 4-01(a) of Regulation S-X regarding the compliance date for SFAS No. 123R. This amendment modified the effective dates of SFAS No. 123R, requiring adoption of this standard on the first interim or annual reporting period of the first fiscal year beginning on or after June 15, 2005. Accordingly, the Company will adopt SFAS No. 123R effective January 1, 2006. We further describe this pronouncement and its anticipated impact on our results of operations in "Net Sales and Expense Components – Stock-based expense." The effect of expensing the fair value of stock options using the Black-Scholes model and the provisions of SFAS No. 123 on our historical results of operations is presented in Note 2 to our consolidated financial statements in Item 8 of this report.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections,* which replaced APB Opinion No. 20, *Accounting Changes*, and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements.* SFAS No. 154 changes the requirements for the accounting and reporting of a change in accounting principle and requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. The Company will adopt the provisions of SFAS No. 154 effective January 1, 2006.

## Quantitative and Qualitative Disclosures About Market Risk

### *Interest Rate Risk*

Our exposure to interest rate risk arises principally from the variable rates associated with our credit facility. On December 31, 2005, we had borrowings of $3.8 million under our credit facility which are subject to a variable annual interest rate, which is currently 5.7% per year. The carrying value of these borrowings approximates fair value due to the variable rate. Based on this debt level, a 10% increase in the interest rate of all such borrowings would cause us to incur an increase in interest expense of approximately $21,000 on an annual basis. We currently do not hedge our exposure to interest rate fluctuations, but may do so in the future.

### *Foreign Currency Exchange Rate Fluctuations*

Fluctuations in the rate of exchange between the U.S. dollar and foreign currencies could adversely affect our financial results. Approximately 30% and 33% of our total net sales were denominated in foreign currencies during the years ended December 31, 2005 and 2004, respectively, and we expect that foreign currencies will continue to represent a similarly significant percentage of our net sales in the future. Costs related to these sales are largely denominated in the same respective currencies, thereby limiting our transaction risk exposure. However, for sales not denominated in U.S. dollars, if there is an increase in the rate at which a foreign currency is exchanged for U.S. dollars, it will require more of the foreign currency to equal a specified amount of U.S. dollars than before the rate increase. In such cases, if we price our products in the foreign currency, we will receive less in U.S. dollars than we did before the rate increase went into effect. If we price our products in U.S. dollars and competitors price their products in local currency, an increase in the relative strength of the U.S. dollar could result in our prices not being competitive in a market where business is transacted in the local currency.

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

As discussed in Note 2 to our consolidated financial statements in Item 8 of this report, we enter into certain short-term derivative financial instruments in the form of foreign currency forward contracts. These forward contracts are designed to mitigate our exposure to currency fluctuations in our intercompany balances denominated in euros, Japanese yen, British pounds, and Canadian dollars. Any change in the fair value of these forward contracts as a result of a fluctuation in a currency exchange rate is expected to be offset by a change in the value of the intercompany balance. These contracts are effectively closed at the end of each reporting period.

## Report of Independent Registered Public Accounting Firm

**The Board of Directors and Stockholders**
**Wright Medical Group, Inc.:**

We have audited the accompanying consolidated balance sheets of Wright Medical Group, Inc. and subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of operations, changes in stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2005. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Wright Medical Group, Inc. and subsidiaries as of December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the internal control over financial reporting of Wright Medical Group, Inc. and subsidiaries as of December 31, 2005, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 27, 2006 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

KPMG LLP

Memphis, Tennessee
February 27, 2006

## Report of Independent Registered Public Accounting Firm

**The Board of Directors and Stockholders**
**Wright Medical Group, Inc.:**

We have audited management's assessment, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting, that Wright Medical Group, Inc. and subsidiaries maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, management's assessment that Wright Medical Group, Inc. and subsidiaries maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, Wright Medical Group, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Wright Medical Group, Inc. and subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of operations, changes in stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2005, and our report dated February 27, 2006 expressed an unqualified opinion on those consolidated financial statements.


Memphis, Tennessee
February 27, 2006

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

| | December 31, | |
|---|---|---|
| | 2005 | 2004 |
| **Assets:** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 51,277 | $ 83,470 |
| Marketable securities | 25,000 | - |
| Accounts receivable, net | 61,729 | 61,662 |
| Inventories | 82,381 | 76,269 |
| Prepaid expenses | 11,025 | 4,822 |
| Deferred income taxes | 24,218 | 24,082 |
| Other current assets | 4,751 | 4,717 |
| Total current assets | 260,381 | 255,022 |
| Property, plant and equipment, net | 81,206 | 70,207 |
| Goodwill | 7,829 | 8,845 |
| Intangible assets, net | 12,724 | 17,140 |
| Deferred income taxes | 8,217 | 8,873 |
| Other assets | 1,453 | 1,071 |
| Total assets | $ 371,810 | $ 361,158 |
| **Liabilities and Stockholders' Equity:** | | |
| Current liabilities: | | |
| Accounts payable | $ 13,572 | $ 13,969 |
| Accrued expenses and other current liabilities | 45,055 | 44,919 |
| Current portion of long-term obligations | 5,628 | 6,331 |
| Total current liabilities | 64,255 | 65,219 |
| Long-term obligations | 1,728 | 5,952 |
| Deferred income taxes | 151 | 26 |
| Other liabilities | 13,668 | 13,892 |
| Total liabilities | 79,802 | 85,089 |
| Commitments and contingencies (Note 15) | | |
| Stockholders' equity: | | |
| Common stock, voting, $.01 par value, shares authorized - 100,000,000; shares issued and outstanding – 34,175,696 in 2005, 33,850,202 in 2004 | 342 | 339 |
| Additional paid-in capital | 274,312 | 269,944 |
| Deferred compensation | - | (188) |
| Accumulated other comprehensive income | 11,957 | 21,642 |
| Accumulated income (deficit) | 5,397 | (15,668) |
| Total stockholders' equity | 292,008 | 276,069 |
| | $ 371,810 | $ 361,158 |

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

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

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| Net sales | $ 319,137 | $ 297,539 | $ 248,932 |
| Cost of sales | 91,740 | 84,183 | 67,815 |
| Gross profit | 227,397 | 213,356 | 181,117 |
| Operating expenses: | | | |
| Selling, general and administrative | 166,916 | 151,144 | 127,612 |
| Research and development | 22,283 | 18,421 | 16,151 |
| Amortization of intangible assets | 4,250 | 3,889 | 3,562 |
| Stock-based expense[1] | 467 | 1,489 | 2,068 |
| Acquired in-process research and development costs | - | - | 4,558 |
| Total operating expenses | 193,916 | 174,943 | 153,951 |
| Operating income | 33,481 | 38,413 | 27,166 |
| Interest (income) expense, net | (176) | 1,064 | 1,107 |
| Other expense (income), net | 237 | (74) | (1,060) |
| Income before income taxes | 33,420 | 37,423 | 27,119 |
| Provision for income taxes | 12,355 | 13,401 | 9,722 |
| Net income | $ 21,065 | $ 24,022 | $ 17,397 |
| **Net income per share (Note 12):** | | | |
| Basic | $ 0.62 | $ 0.72 | $ 0.53 |
| Diluted | $ 0.60 | $ 0.68 | $ 0.50 |
| Weighted-average number of shares outstanding – basic | 33,959 | 33,391 | 32,857 |
| Weighted-average number of shares outstanding – diluted | 35,199 | 35,317 | 34,561 |

[1] Amounts presented as non-cash stock-based expense consist of the following for the periods indicated:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| Cost of sales | $ 12 | $ 68 | $ 107 |
| Selling, general and administrative | 449 | 1,364 | 1,875 |
| Research and development | 6 | 57 | 86 |
| | $ 467 | $ 1,489 | $ 2,068 |

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

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

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| **Operating activities:** | | | |
| Net income | $ 21,065 | $ 24,022 | $ 17,397 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation | 17,895 | 17,278 | 13,948 |
| Amortization of deferred financing costs | 262 | 261 | 261 |
| Amortization of intangible assets | 4,250 | 3,889 | 3,562 |
| Deferred income taxes | (329) | 5,068 | 4,565 |
| Stock-based expenses | 467 | 1,489 | 2,068 |
| In-process research and development costs | - | - | 4,558 |
| Other | 1,386 | 623 | 275 |
| Changes in assets and liabilities, net of acquisitions: | | | |
| Accounts receivable | (5,177) | (3,811) | (11,359) |
| Inventories | (9,364) | (7,861) | (3,466) |
| Marketable securities | (25,000) | - | - |
| Other current assets | (6,062) | (3,223) | (676) |
| Accounts payable | 647 | (849) | 3,153 |
| Accrued expenses and other liabilities | 5,251 | 479 | 5,779 |
| Net cash provided by operating activities | 5,291 | 37,365 | 40,065 |
| **Investing activities:** | | | |
| Capital expenditures | (30,356) | (18,316) | (18,116) |
| Purchase of tangible and intangible assets (Note 3) | (1,227) | (161) | (7,799) |
| Other | - | 49 | 71 |
| Net cash used in investing activities | (31,583) | (18,428) | (25,844) |
| **Financing activities:** | | | |
| Issuance of common stock | 2,930 | 4,056 | 1,678 |
| Financing under factoring agreements, net | (1,208) | (29) | 4,680 |
| Payments of bank and other financing | (7,101) | (6,332) | (5,844) |
| Net cash (used in) provided by financing activities | (5,379) | (2,305) | 514 |
| Effect of exchange rates on cash and cash equivalents | (522) | 267 | 463 |
| Net (decrease) increase in cash and cash equivalents | (32,193) | 16,899 | 15,198 |
| Cash and cash equivalents, beginning of period | 83,470 | 66,571 | 51,373 |
| Cash and cash equivalents, end of period | $ 51,277 | $ 83,470 | $ 66,571 |

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

**Wright Medical Group, Inc.**
**Consolidated Statements of Changes in Stockholders' Equity and Comprehensive Income**
**For the Years Ended December 31, 2003, 2004 and 2005** (In thousands, except share data)

| | Common Stock, Voting | | | | | | |
|---|---|---|---|---|---|---|---|
| | Number of Shares | Amount | Additional Paid-in Capital | Accumulated (Deficit) Income | Deferred Compensation | Accumulated Other Comprehensive Income | Total Stockholders' Equity |
| Balance at December 31, 2002 | 32,712,374 | $ 327 | $ 260,640 | $ (57,087) | $ (3,164) | $ 4,283 | $ 204,999 |
| 2003 Activity: | | | | | | | |
| Net income | - | - | - | 17,397 | - | - | 17,397 |
| Foreign currency translation | - | - | - | - | - | 11,392 | 11,392 |
| Total comprehensive income | | | | | | | 28,789 |
| Issuance of common stock, net of costs | 328,373 | 3 | 1,675 | - | - | - | 1,678 |
| Tax benefit of employee stock option exercises | - | - | 784 | - | - | - | 784 |
| Stock-based compensation | - | - | 593 | - | 1,475 | - | 2,068 |
| Forfeiture of stock options | - | - | (237) | - | 237 | - | - |
| Balance at December 31, 2003 | 33,040,747 | $ 330 | $ 263,455 | $ (39,690) | $ (1,452) | $ 15,675 | $ 238,318 |
| 2004 Activity: | | | | | | | |
| Net income | - | - | - | 24,022 | - | - | 24,022 |
| Foreign currency translation | - | - | - | - | - | 5,967 | 5,967 |
| Total comprehensive income | | | | | | | 29,989 |
| Issuance of common stock, net of costs | 809,455 | 9 | 4,047 | - | - | - | 4,056 |
| Tax benefit of employee stock option exercises | - | - | 2,217 | - | - | - | 2,217 |
| Stock-based compensation | - | - | 331 | - | 1,158 | - | 1,489 |
| Forfeiture of stock options | - | - | (106) | - | 106 | - | - |
| Balance at December 31, 2004 | 33,850,202 | $ 339 | $ 269,944 | $ (15,668) | $ (188) | $ 21,642 | $ 276,069 |
| 2005 Activity: | | | | | | | |
| Net income | - | - | - | 21,065 | - | - | 21,065 |
| Foreign currency translation | - | - | - | - | - | (9,685) | (9,685) |
| Total comprehensive income | | | - | - | - | - | 11,380 |
| Issuance of common stock, net of costs | 325,494 | 3 | 2,927 | - | - | - | 2,930 |
| Tax benefit of employee stock option exercises | - | - | 1,162 | - | - | - | 1,162 |
| Stock-based compensation | - | - | 288 | - | 179 | - | 467 |
| Forfeiture of stock options | - | - | (9) | - | 9 | - | - |
| Balance at December 31, 2005 | 34,175,696 | $ 342 | $ 274,312 | $ 5,397 | $ - | $ 11,957 | $ 292,008 |

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

## 1. Organization and Description of Business:

Wright Medical Group, Inc. (the "Company"), through Wright Medical Technology, Inc. and other operating subsidiaries, is a global medical device company specializing in the design, manufacture and marketing of reconstructive joint devices and biologics products. The Company's products are sold through a network of independent sales representatives in the United States ("U.S.") and by a combination of employee sales representatives, independent sales representatives, and stocking distributors outside the U.S. The Company promotes its products in over 60 countries with principal markets in the U.S., Europe, and Japan. The Company is headquartered in suburban Memphis, Tennessee.

The Company was incorporated on November 23, 1999 as a Delaware corporation (previously named Wright Acquisition Holdings, Inc.) and had no operations until an investment group led by Warburg, Pincus Equity Partners, L.P. ("Warburg") acquired majority ownership of Wright Medical Technology, Inc. (the "Predecessor Company") on December 7, 1999. This transaction, which represents a recapitalization of the Predecessor Company and the inception of the Company in its present form, was accounted for using the purchase method of accounting.

On December 22, 1999 the Company acquired all of the outstanding common stock of Cremascoli Ortho Holding, S.A. ("Cremascoli"), an orthopaedic medical device company headquartered in Toulon, France. The acquisition was accounted for using the purchase method of accounting and, accordingly, the results of operations of Cremascoli have been included in the Company's consolidated financial statements from the date of acquisition.

On July 18, 2001, the Company completed its initial public offering (the "IPO"), issuing 7,500,000 shares of common stock which generated net proceeds of $84.8 million. On March 6, 2002, the Company and certain selling stockholders completed a secondary offering which generated net proceeds of $49.5 million.

## 2. Summary of Significant Accounting Policies:

***Principles of Consolidation.*** The accompanying consolidated financial statements include the accounts of the Company and its wholly owned domestic and international subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

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

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

***Marketable Securities.*** During 2005, the Company invested $25 million of its excess cash balance in marketable debt securities that are not considered cash equivalents. The Company classifies these debt securities as trading securities and includes these amounts as "Marketable Securities" in its consolidated balance sheet. The Company recognizes realized and unrealized gains or losses on the purchase or sale of these securities in the period incurred in the accompanying consolidated statement of operations. For the year ended December 31, 2005, the Company did not incur any realized or unrealized gains or losses related to these securities.

***Inventories.*** The Company's inventories are valued at the lower of cost or market on a first-in, first-out ("FIFO") basis. Inventory costs include material, labor costs and manufacturing overhead. The Company regularly reviews inventory quantities on hand for excess and obsolete inventory and, when circumstances indicate, the Company incurs charges to write down inventories to their net realizable value. The Company's review of inventory for excess and obsolete quantities is based primarily on its estimated forecast of product demand and production requirements for the next twenty-four months. Charges incurred for excess and obsolete inventory were $6.9 million, $5.8 million and $2.6 million for the years ended December 31, 2005, 2004 and 2003, respectively. In 2005, charges incurred for excess and obsolete inventory included $1.5 million recorded to write down certain inventory to its net realizable value due to the termination of an agreement to distribute certain third party spinal products in Europe. In 2004, charges incurred for excess and obsolete inventory included $2.4 million recorded to write down certain foot and ankle implant inventory to its net realizable value as a result of the Company's transition to the CHARLOTTE™ Foot and Ankle System from a line of products supplied by a third party vendor pursuant to a distribution agreement that expired in the first quarter of 2005.

***Product Liability Claims.*** The Company makes provisions for claims specifically identified for which it believes the likelihood of an unfavorable outcome is probable and an estimate of the amount of loss has been developed. The Company has recorded at least the minimum estimated liability related to those claims where a range of loss has been established. The Company's accrual for product liability claims was approximately $850,000 and $1.0 million at December 31, 2005 and 2004, respectively.

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

| | |
|---|---|
| Land improvements | 15 to 25 years |
| Buildings | 10 to 45 years |
| Machinery and equipment | 3 to 20 years |
| Furniture, fixtures and office equipment | 1 to 14 years |
| Surgical instruments | 5 to 6 years |

Expenditures for major renewals and betterments that extend the useful life of the assets are capitalized. Maintenance and repair costs are charged to expense as incurred. Upon sale or retirement, the asset cost and related accumulated depreciation are eliminated from the respective accounts and any resulting gain or loss is included in income.

***Intangible Assets and Goodwill***. Goodwill is recognized for the excess of the purchase price over the fair value of assets of businesses acquired. Goodwill is required to be tested for impairment at least annually. Unless circumstances otherwise dictate, we perform our annual impairment test in the fourth quarter. Accordingly, during the fourth quarter of 2005, the Company evaluated goodwill for impairment and determined that the fair values of its reporting unit exceeded its carrying value, indicating that goodwill was not impaired. Based on the Company's single business approach to decision-making, planning, and resource allocation, management has determined that the Company has only one reporting unit for purposes of evaluating goodwill for impairment.

The Company's intangible assets with estimable useful lives are amortized on a straight line basis over their respective estimated useful lives to their estimated residual values, and are reviewed for impairment in accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, *Accounting for Impairment or Disposal of Long-Lived Assets*. The weighted average amortization periods for completed technology, distribution channels, trademarks and licenses are 8 years, 10 years, 9 years, and 6 years, respectively. The weighted average amortization period of the Company's intangible assets on a combined basis is 8 years.

***Valuation of Long-Lived Assets***. Management periodically evaluates carrying values of long-lived assets, including property, plant and equipment and intangible assets, when events and circumstances indicate that these assets may have been impaired. The Company accounts for the impairment of long-lived assets in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.* Accordingly, the Company evaluates impairment of its property, plant and equipment based upon an analysis of estimated undiscounted future cash flows. If it is determined that a change is required in the useful life of an asset, future depreciation/amortization is adjusted accordingly. Alternatively, should the Company determine that an asset is impaired, an adjustment would be charged to income based on its fair market value, or discounted cash flows if the fair market value is not readily determinable, reducing income in that period.

***Allowances for Doubtful Accounts***. The Company experiences some credit loss on its accounts receivable and accordingly it must make estimates related to the ultimate collection of its accounts receivable. Specifically, management analyzes the Company's accounts receivable, historical bad debt experience, customer concentrations, customer credit-worthiness, and current economic trends, when evaluating the adequacy of its allowance for doubtful accounts. The majority of the Company's receivables are from hospitals, many of which are government funded. Accordingly, the Company's collection history with this class of customer has been favorable. Historically, the Company has experienced minimal bad debts from its hospital customers and more significant bad debts from certain international distributors, typically as a result of specific financial difficulty or geo-political factors. The Company writes off receivables when it determines that the receivables are uncollectible, typically upon customer bankruptcy or the customer's non-response to collection efforts. The Company's allowance for doubtful accounts totaled $2.0 million and $1.8 million at December 31, 2005 and 2004, respectively.

***Concentrations of Supply of Raw Material***. The Company relies on a limited number of suppliers for the components used in the Company's products. The Company's reconstructive joint devices are produced from various surgical grades of titanium, cobalt chrome and stainless steel, various grades of high-density polyethylenes, silicone elastomer and ceramics. The Company relies on one supplier for the silicone elastomer used in the Company's extremity products. The Company is aware of only two suppliers of silicone elastomer to the medical device industry for permanent implant usage. Further, the Company relies on one supplier of ceramics for use in the Company's hip products. In addition, for the Company's biologics products, it presently depends on a single source for demineralized bone matrix ("DBM") and cancellous bone matrix ("CBM") materials. Two not-for-profit tissue banks supplied the Company with all of the DBM and CBM that it used in 2005 in its allograft products. Further, the Company relies on one supplier for its GRAFTJACKET® family of soft tissue repair and graft containment products, as well as one supplier for its ADCON® Gel products.

***Income Taxes***. Income taxes are accounted for pursuant to the provisions of SFAS No. 109, *Accounting for Income Taxes* ("SFAS No. 109"). The Company's effective tax rate is based on income by tax jurisdiction, statutory rates and tax saving initiatives available to it in the various jurisdictions in which it operates. Significant judgment is required in determining the Company's effective tax rate and evaluating its tax positions. This process includes assessing temporary differences resulting from differing recognition of items for income tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within the Company's consolidated balance sheet.

***Revenue Recognition***. The Company's revenues are generated through two types of customers, hospitals and stocking distributors, with the majority of the Company's revenue derived from sales to hospitals. The Company's products are sold through a network of independent sales representatives in the U.S. and by a combination of employee sales representatives, independent sales representatives, and stocking distributors outside the U.S. Revenues from sales to hospitals are recorded when the hospital takes title to the product, which is when the product is surgically implanted in a patient and a purchase order is received from the hospital. The Company views the receipt of a purchase order as the evidence of customer acceptance of the product.

The Company records revenues from sales to its stocking distributors outside the U.S. at the time the product is shipped to the distributor. Stocking distributors, who sell the products to their customers, take title to the products and assume all risks of ownership. The Company's distributors are obligated to pay within specified terms regardless of when, if ever, they sell the products. In general, the distributors do not have any rights of return or exchange; however, in limited situations the Company has repurchase agreements with certain stocking distributors. Those certain agreements require the Company to repurchase a specified percentage of the inventory purchased by the distributor within a specified period of time prior to the expiration of the contract. During those specified periods, the Company defers the applicable percentage of the sales. Approximately $170,000 and $90,000 of deferred revenue related to these types of agreements was recorded at December 31, 2005 and 2004, respectively.

The Company must make estimates of potential future product returns related to current period product revenue. The Company develops these estimates by analyzing historical experience related to product returns. Judgment must be used and estimates made in connection with establishing the allowance for sales returns in any accounting period. An allowance for sales returns of approximately $430,00 and $400,000 is included as a reduction of accounts receivable at December 31, 2005 and 2004, respectively.

***Shipping and Handling Costs.*** The Company incurs shipping and handling costs associated with the shipment of goods to customers, independent distributors and its subsidiaries. All shipping and handling amounts billed to customers are included in net sales. All shipping and handling costs associated with the shipment of goods to customers are included in cost of sales. All other shipping and handling costs are included in selling, general and administrative expenses.

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

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

***Comprehensive Income.*** Comprehensive income is defined as the change in equity during a period related to transactions and other events and circumstances from non-owner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. The difference between the Company's net income and its comprehensive income is wholly attributable to foreign currency translation.

***Stock-Based Compensation.*** At December 31, 2005, the Company has two stock-based employee compensation plans, which are described in Note 13. The Company accounts for those plans under the intrinsic value method in accordance with the provisions of Accounting Principles Board (APB) Opinion No. 25.

***Accounting for Stock Issued to Employees.*** Accordingly, compensation cost related to stock option grants to employees has been recognized only to the extent that the fair market value of the stock exceeds the exercise price of the stock option at the date of the grant. Non-employee stock-based compensation is accounted for in accordance with SFAS No. 123, *Accounting for Stock-Based Compensation.*

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to non-cash stock-based employee compensation (in thousands, except per share amounts):

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| Net income, as reported | $ 21,065 | $ 24,022 | $ 17,397 |
| Add: Stock-based employee compensation cost recognized under intrinsic value method, net of tax effects | 151 | 681 | 920 |
| Less: Stock-based employee compensation expense determined under fair value based method, net of tax effects | (12,972) | (8,626) | (4,334) |
| Pro forma net income | $ 8,244 | $ 16,077 | $ 13,983 |
| Net income per share: | | | |
| Basic, as reported | $ 0.62 | $ 0.72 | $ 0.53 |
| Basic, pro forma | $ 0.24 | $ 0.48 | $ 0.43 |
| Diluted, as reported | $ 0.60 | $ 0.68 | $ 0.50 |
| Diluted, pro forma | $ 0.24 | $ 0.47 | $ 0.41 |

In December 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 123 (Revised 2004), *Share Based Payment* ("SFAS No. 123R"), effective for interim or annual reporting periods beginning after June 15, 2005. SFAS No. 123R requires the recognition of compensation expense for the fair value of share-based transactions. The fair value must be determined as of the date of grant using a valuation model such as Black-Scholes or a binomial lattice model. In April 2005, the SEC amended Rule 4-01(a) of Regulation S-X regarding the compliance date for SFAS No. 123R. This amendment modified the effective dates of SFAS No. 123R, requiring adoption of this standard on the first interim or annual reporting period of the first fiscal year beginning on or after June 15, 2005. Accordingly, the Company adopted SFAS No. 123R effective January 1, 2006. Although management's evaluation of SFAS No. 123R is not complete, the Company estimates that the amount of non-cash stock-based compensation that it will record in 2006 pursuant to the adoption of SFAS No. 123R will be significant. The effect on the Company's historical results of operations of expensing the fair value of stock options using the Black-Scholes

model and the provisions of SFAS No. 123 is presented in the table above. Note 13 provides information related to the Company's assumptions in applying the Black-Scholes methodology to its option grants.

***Fair Value of Financial Instruments.*** The carrying value of cash and cash equivalents, accounts receivable, accounts payable and notes payable approximates the fair value of these financial instruments at December 31, 2005 and 2004 due to their short maturities or variable rates.

***Derivative Instruments and Hedging Activities.*** The Company accounts for derivative instruments and hedging activities under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by SFAS No. 138. Accordingly, all of the Company's derivative instruments are recorded on the balance sheet as either an asset or liability and measured at fair value. The changes in the derivative's fair value are recognized currently in earnings unless specific hedge accounting criteria are met.

The Company employs a derivative program, which began in 2004, using 30-day foreign currency forward contracts to mitigate the risk of currency fluctuations on its intercompany receivable and payable balances that are denominated in foreign currencies. These forward contracts are expected to offset the transactional gains and losses on the related intercompany balances. These forward contracts are not designated as hedging instruments under SFAS No. 133. Accordingly, the changes in the fair value and the settlement of the contracts are recognized in the period incurred in the accompanying consolidated statement of operations.

The Company recorded net gains of approximately $1.5 million for the year ended December 31, 2005, and net losses of approximately $790,000 during the year ended December 31, 2004, on foreign currency contracts, which are included in "Other (income) expense, net" in the Company's consolidated statements of operations. These gains and losses substantially offset translation losses and gains recorded on the Company's intercompany receivable and payable balances, also included in "Other (income) expense, net." At December 31, 2005 and 2004, the Company had no foreign currency contracts outstanding.

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

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| Interest | $ 657 | $ 717 | $ 994 |
| Income taxes | $ 17,057 | $ 8,289 | $ 4,411 |

During 2004, the Company favorably resolved certain income tax contingencies associated with the Company's acquisition of Cremascoli, resulting in a decrease in goodwill of approximately $3.0 million. Additionally, the Company entered into capital leases of approximately $1.6 million, $1.1 million, and $630,000 during 2005, 2004, and 2003, respectively.

***Reclassifications.*** Certain prior year amounts have been reclassified to conform to the 2005 presentation.

***Recent Pronouncements.*** In November 2004, the FASB issued SFAS No. 151, *Inventory Costs - An Amendment of ARB No. 43, Chapter 4* ("SFAS No. 151"). SFAS No. 151 will no longer allow companies to capitalize inventory costs on their balance sheet when the production defect rate varies significantly from the expected rate. All abnormal freight, handling and material waste will be treated as period expenses. Additionally, SFAS No. 151 requires that a facility's fixed production overhead be charged to inventory based on a range of "normal" capacity. If the production level is abnormally low, unallocated overhead should be charged to current period expense. SFAS No. 151 is required to be adopted for annual periods beginning after June 15, 2005. Accordingly, the Company will adopt the provisions of SFAS No. 151 effective January 1, 2006. Management does not believe that the impact of this statement will have a material impact on the Company's results of operations or financial statements.

In April 2005, the SEC amended Rule 4-01(a) of Regulation S-X regarding the compliance date for SFAS No. 123 (Revised 2004), *Share Based Payment* ("SFAS No. 123R"). This amendment modified the effective dates of SFAS No. 123R, requiring adoption of this standard on the first interim or annual reporting period of the first fiscal year beginning on or after June 15, 2005. Accordingly, the Company will adopt SFAS No. 123R effective January 1, 2006. The Company anticipates that it will record material amounts of incremental non-cash stock-based expense in future periods following the adoption of SFAS No. 123R.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections*, which replaced APB Opinion No. 20, *Accounting Changes*, and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements.* SFAS No. 154 changes the requirements for the accounting and reporting of a change in accounting principle and requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. The Company will adopt the provisions of SFAS No. 154 effective January 1, 2006.

### 3. Acquisition of Assets:

On March 5, 2003, the Company completed an acquisition of certain assets from Gliatech Inc. related to its ADCON® Gel technology for $8.4 million in cash. Additionally, the Company entered into a royalty agreement that requires the Company to pay a royalty on future product sales. The Company paid $840,000 of the purchase price as a deposit in the fourth quarter of 2002, and $3.4 million in the first quarter of 2003. The remaining $4.2 million was paid in the second quarter of 2003 upon final receipt of all assets. The following table summarizes the allocation of the purchase price (in thousands):

| | |
|---|---|
| Inventories | $ 1,312 |
| Property, plant and equipment | 160 |
| Acquired in-process research and development | 4,558 |
| Intangible assets: | |
| Completed Technology | 1,575 |
| Trademarks | 554 |
| Other | 286 |
| | $ 8,445 |

In connection with the acquisition of these assets, the Company engaged an independent third party to conduct a valuation of the intangible assets acquired. The value assigned to acquired in-process research and development ("IPRD") was $4.6 million of the purchase price. Accordingly, this amount was expensed in the first quarter of 2003. The value assigned to IPRD was determined by estimating the costs to develop the IPRD into commercially viable products, estimating the resulting cash flows from such projects, and discounting the net cash flows using a 32% risk adjusted discount rate. This discount rate reflected uncertainties surrounding the successful development of the IPRD.

In June 2005, the Company's pre-market approval application (PMA) with the United States Food and Drug Administration ("FDA") for the ADCON® Gel product was withdrawn. Based on the progress of the review to date, the Company determined that in order to adequately address the requests made by the FDA in connection with the review of the application, withdrawal of the filing at this time is appropriate. The Company is evaluating whether to continue to pursue re-submission. If re-submitted, there can be no assurance that the FDA will accept another submission in a timely manner or at all.

## 4. Inventories:

Inventories consist of the following (in thousands):

| | December 31, | |
|---|---|---|
| | 2005 | 2004 |
| Raw materials | $ 4,186 | $ 3,373 |
| Work-in-process | 14,417 | 14,306 |
| Finished goods | 63,778 | 58,590 |
| | $ 82,381 | $ 76,269 |

## 5. Property, Plant and Equipment:

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

| | December 31, | |
|---|---|---|
| | 2005 | 2004 |
| Land and land improvements | $ 2,329 | $ 1,944 |
| Buildings | 8,458 | 8,773 |
| Machinery and equipment | 33,530 | 31,849 |
| Furniture, fixtures and office equipment | 29,193 | 25,444 |
| Construction in progress | 2,654 | 2,284 |
| Surgical instruments | 72,088 | 56,963 |
| | 148,252 | 127,257 |
| Less: Accumulated depreciation | (67,046) | (57,050) |
| | $ 81,206 | $ 70,207 |

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

| | December 31, | |
|---|---|---|
| | 2005 | 2004 |
| Land and land improvements | $ 235 | $ 269 |
| Buildings | 3,018 | 3,247 |
| Machinery and equipment | 6,346 | 8,103 |
| Furniture, fixtures and office equipment | 2,309 | 2,135 |
| | 11,908 | 13,754 |
| Less: Accumulated depreciation | (5,663) | (5,940) |
| | $ 6,245 | $ 7,814 |

Depreciation expense approximated $17.9 million, $17.3 million, and $13.9 million for the years ended December 31, 2005, 2004, and 2003, respectively, and included amortization of assets under capital leases.

## 6. Goodwill and Intangible Assets:

Changes in the carrying amount of goodwill occurring during the year ended December 31, 2005 are as follows (in thousands):

| | |
|---|---|
| Goodwill, at December 31, 2004 | $ 8,845 |
| Less: Foreign currency translation | (1,016) |
| Goodwill, at December 31, 2005 | $ 7,829 |

The components of the Company's identifiable intangible assets are as follows (in thousands):

| | December 31, 2005 | | December 31, 2004 | |
|---|---|---|---|---|
| | Cost | Accumulated Amortization | Cost | Accumulated Amortization |
| Distribution channels | $ 18,173 | $ 10,908 | $ 20,797 | $ 10,399 |
| Completed technology | 5,243 | 2,353 | 5,348 | 1,733 |
| Licenses | 2,756 | 1,847 | 2,683 | 1,538 |
| Trademarks | 657 | 230 | 657 | 152 |
| Other | 4,014 | 2,781 | 3,303 | 1,826 |
| | 30,843 | $ 18,119 | 32,788 | $ 15,648 |
| Less: Accumulated amortization | (18,119) | | (15,648) | |
| Intangible assets, net | $ 12,724 | | $ 17,140 | |

Based on the intangible assets held at December 31, 2005, we expect to amortize approximately $4.0 million in 2006, $3.0 million in 2007, $2.7 million in 2008, $2.4 million in 2009 and $350,000 in 2010.

## 7. Accrued Expenses and Other Current Liabilities:

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

| | December 31, | |
|---|---|---|
| | 2005 | 2004 |
| Employee benefits | $ 10,873 | $ 11,476 |
| Advances from factoring arrangement | 3,547 | 5,242 |
| Royalties | 4,455 | 4,664 |
| Taxes other than income | 5,604 | 4,120 |
| Commissions | 3,982 | 3,818 |
| Professional fees | 3,994 | 3,129 |
| Purchased technology | 1,500 | 1,500 |
| Legal | 1,429 | 1,153 |
| Other | 9,671 | 9,817 |
| | $ 45,055 | $ 44,919 |

## 8. Long-Term Obligations:

Long-term obligations consist of the following (in thousands):

| | December 31, | |
|---|---|---|
| | 2005 | 2004 |
| Notes payable | $ 3,750 | $ 8,750 |
| Capital lease obligations | 3,606 | 3,533 |
| | 7,356 | 12,283 |
| Less: current portion | (5,628) | (6,331) |
| | $ 1,728 | $ 5,952 |

In August 2001, the Company entered into a five-year senior credit facility with a syndicate of commercial banks. This senior credit facility consists of $20 million in term loans and a revolving loan facility of up to $60 million. The Company had borrowings outstanding under the term loan of $3.8 million and $8.8 million at December 31, 2005 and 2004, respectively. The remaining balance under the term loan will be repaid in 2006 in accordance with the company's credit agreement.

Borrowings under the senior credit facility are guaranteed by all of the Company's subsidiaries and collateralized by all of the assets of Wright Medical Technology, Inc., the Company's wholly-owned subsidiary. The credit facility contains customary covenants including, among other things, restrictions on the ability to pay cash dividends, prepay debt, incur additional debt and sell assets. The credit facility also requires the Company to maintain certain financial covenants, including a specified consolidated leverage (or debt-to-equity) ratio and a specified consolidated fixed charge coverage ratio. In the event that the Company violates any covenants, it could be required to repay the remaining balance of the debt. Additionally, should the Company be required to repay the loan before its scheduled maturity, a charge to operating income for unamortized financing costs would be incurred. At the Company's option, borrowings under the credit facility bear interest either at a rate equal to a fixed base rate plus a spread of 0.75% to 1.25% or at a rate equal to an adjusted LIBOR plus a spread of 1.75% to 2.25%, depending on the consolidated leverage ratio, with a current annual rate of 5.7%.

At December 31, 2005, the Company had availability under committed credit facilities, after considering outstanding letters of credit, totaling $59.9 million.

As discussed in Note 5, the Company has acquired certain property and equipment pursuant to capital leases. These leases have various maturity dates ranging from one to seven years with interest rates ranging from 4.0% to 8.9%. At December 31, 2005, future minimum lease payments under capital lease obligations, together with the present value of the net minimum lease payments, are as follows (in thousands):

| | |
|---|---|
| 2006 | $ 2,008 |
| 2007 | 1,179 |
| 2008 | 399 |
| 2009 | 172 |
| 2010 | 94 |
| Thereafter | 6 |
| Total minimum payments | 3,858 |
| Less amount representing interest | (252) |
| Present value of minimum lease payments | 3,606 |
| Current portion | (1,878) |
| Long-term portion | $ 1,728 |

## 9. Other Long-Term Liabilities:

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

| | December 31, | |
|---|---|---|
| | 2005 | 2004 |
| Accrued income taxes payable | $ 13,045 | $ 12,951 |
| Other | 623 | 941 |
| | $ 13,668 | $ 13,892 |

## 10. Capital Stock:

*Common Stock*. The Company is authorized to issue up to 100,000,000 shares of voting common stock. The Company has 65,824,304 shares of voting common stock available for future issuance at December 31, 2005.

*Warrants*. In connection with the December 1999 recapitalization, the Company issued warrants to stockholders and certain employees to purchase an aggregate of 727,276 shares of the Company's common stock at an exercise price of $4.35 per share. The warrants were exercisable at any time after issuance and, unless exercised, expired five years from the date of issuance. During the years ended December 31, 2004 and 2003, warrants for 353,209 and 6,691 shares were exercised, respectively. All warrants were exercised as of December 31, 2004.

## 11. Income Taxes:

The components of the Company's income before income taxes are as follows (in thousands):

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| Domestic | $ 43,588 | $ 40,437 | $ 25,675 |
| Foreign | (10,168) | (3,014) | 1,444 |
| Income before income taxes | $ 33,420 | $ 37,423 | $ 27,119 |

The components of the Company's provision for income taxes are as follows (in thousands):

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| Current provision: | | | |
| Domestic: | | | |
| Federal | $ 9,777 | $ 12,815 | $ 3,080 |
| State | 1,709 | 811 | 203 |
| Foreign | 1,385 | 4,401 | 1,404 |
| Deferred provision (benefit): | | | |
| Domestic: | | | |
| Federal | 3,013 | (197) | 4,313 |
| State | 605 | 803 | 1,098 |
| Foreign | (4,134) | (5,232) | (376) |
| Total provision for income taxes | $ 12,355 | $ 13,401 | $ 9,722 |

A reconciliation of the statutory federal income tax rate to the Company's effective income tax rate is as follows:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| Income tax provision at statutory rate | 35.0% | 35.0% | 35.0% |
| State tax provision | 5.3% | 4.8% | 4.4% |
| Change in valuation allowance | (1.2%) | (3.1%) | 4.5% |
| Meals and entertainment limitation | 1.5% | 1.0% | 1.2% |
| Research and development credit | (2.3%) | (2.6%) | (9.9%) |
| Tax exempt interest | (1.2%) | - | - |
| Other, net | (0.1%) | 0.7% | 0.7% |
| Total | 37.0% | 35.8% | 35.9% |

The significant components of the Company's deferred tax assets and liabilities as of December 31, 2005 and 2004 are as follows (in thousands):

| | December 31, | |
|---|---|---|
| | 2005 | 2004 |
| Deferred tax assets: | | |
| Operating loss carryforwards | $ 13,924 | $ 13,755 |
| General business credit carryforward | 2,341 | 2,309 |
| Alternative minimum tax credits | - | 621 |
| Reserves and allowances | 18,031 | 19,399 |
| Amortization | 5,230 | 5,660 |
| Other | 11,856 | 11,718 |
| Valuation allowance | (5,964) | (6,820) |
| Total deferred tax assets | 45,418 | 46,642 |
| Deferred tax liabilities: | | |
| Depreciation | 6,205 | 4,523 |
| Acquired intangible assets | 2,661 | 3,767 |
| Other | 4,297 | 5,570 |
| Total deferred tax liabilities | 13,163 | 13,860 |
| Net deferred tax assets | $ 32,255 | $ 32,782 |

Provisions for federal income taxes are not made on the undistributed earnings of foreign subsidiaries when earnings are considered permanently invested. Deferred taxes are not provided for temporary differences related to earnings of non-U.S. subsidiaries that are intended to be permanently reinvested. At

December 31, 2005, the Company did not have undistributed earnings of foreign subsidiaries, as total earnings from these subsidiaries have been offset by losses.

At December 31, 2005, the Company had net operating loss carryforwards for U.S. federal income tax purposes of approximately $15.2 million, which expire in 2017 and 2018. Additionally, the Company had general business credit carryforwards of approximately $2.3 million, which expire beginning in 2007 and extending through 2016. At December 31, 2005, the Company had foreign net operating loss carryforwards of approximately $25.4 million, of which $4.5 million expires beginning in 2009 and extending through 2015.

Certain of the Company's U.S. and foreign net operating losses and general business credit carryforwards are subject to various limitations. The Company maintains valuation allowances for these net operating losses and tax credit carryforwards that are expected to expire unused due to these limitations.

## 12. Earnings Per Share:

SFAS No. 128, *Earnings Per Share*, requires the presentation of basic and diluted earnings per share. Basic earnings per share is calculated based on the weighted-average shares of common stock outstanding during the period. Diluted earnings per share is calculated to include any dilutive effect of the Company's common stock equivalents, which consist of stock options and warrants. The dilutive effect of such instruments is calculated using the treasury-stock method.

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

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| Weighted-average number of common shares outstanding - basic | 33,959 | 33,391 | 32,857 |
| Common stock equivalents | 1,240 | 1,926 | 1,704 |
| Weighted-average number of common shares outstanding - diluted | 35,199 | 35,317 | 34,561 |

For the years ended December 31, 2005, 2004 and 2003, options to purchase approximately 2.7 million, 1.7 million and 671,000, respectively, shares of the Company's common stock were excluded from the calculation of diluted earnings per share because the effect was antidilutive. These stock options were antidilutive because the exercise price of the options was greater than the average market price of common stock for the respective period.

## 13. Stock Option Plans:

At December 31, 2005, the Company has two stock-based incentive plans, which are described below. As permitted by SFAS No. 123, *Accounting for Stock-Based Compensation*, the Company applies APB Opinion No. 25 and related interpretations in accounting for its employee stock option plan. Accordingly, compensation cost related to stock option grants to employees has been recognized only to the extent that the fair market value of the stock exceeds the exercise price of the stock option at the date of the grant.

### *Equity Incentive Plan*

On December 7, 1999, the Company adopted the 1999 Equity Incentive Plan (the "Plan"), which was subsequently amended and restated on July 6, 2001, May 13, 2003, May 13, 2004, and May 12, 2005. The Plan authorizes the Company to grant options to purchase up to 9,767,051 shares of common stock. Under the Plan, options to purchase common stock generally are exercisable in increments of 25% annually in each of the first through fourth anniversaries of the date of grant. Options to purchase Series A Preferred Stock that were outstanding at the time the Company completed its IPO in July 2001 became options to purchase the Company's common stock. Those options were immediately exercisable upon their issuance. All the options issued under the plan expire after ten years.

The weighted-average fair value of the Company's options granted in 2005, 2004 and 2003 was $11.59 per share, $17.39 per share and $12.96 per share, respectively. The fair value of these options is estimated on the date of grant using the Black-Scholes methodology required by SFAS No. 123 for publicly traded companies. In applying the Black-Scholes methodology to the option grants, the Company used the following assumptions:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| Risk-free interest rate | 4.0% - 4.5% | 4.0% - 4.8% | 3.6% - 4.3% |
| Expected option life | 7 years | 7 years | 7 years |
| Expected price volatility | 39.8% | 50.1% | 54.3% |

The assumed forfeiture rate was not material to the calculation. The Company does not assume a dividend yield as it has never declared or paid cash dividends on its common stock.

A summary of the Company's stock option activity is as follows (shares in thousands):

| | Common Stock | |
|---|---|---|
| | Shares | Weighted Avg. Exercise Price |
| Outstanding at December 31, 2002 | 3,288 | $ 7.58 |
| Granted | 1,333 | 21.80 |
| Exercised | (309) | 4.67 |
| Forfeited or expired | (78) | 7.25 |
| Outstanding at December 31, 2003 | 4,234 | $ 12.28 |
| Granted | 2,458 | 30.61 |
| Exercised | (505) | 7.53 |
| Forfeited or expired | (359) | 24.34 |
| Outstanding at December 31, 2004 | 5,828 | $ 19.68 |
| Granted | 1,819 | 23.82 |
| Exercised | (314) | 8.61 |
| Forfeited or expired | (1,145) | 30.01 |
| Outstanding at December 31, 2005 | 6,188 | $ 19.55 |

As of December 31, 2005, there were 1,840,764 options available for future issuance.

In 2005, 2004, and 2003, the Company granted certain independent distributors common stock options for a total of 42,100, 19,900 and 16,750 shares, respectively, under the Plan. The distributors were given options to purchase common stock, exercisable in 25% increments on the first through fourth anniversaries of the date of grant, at a weighted-average exercise price of $25.09, $32.56 and $16.31 per share in 2005, 2004, and 2003, respectively. The options expire after ten years.

In connection with the distributor stock grants discussed above and the issuance of certain stock options to employees and distributors, the Company incurred non-cash stock-based compensation representing the fair value of the stock and stock options granted to distributors, and for employee stock options to the extent the fair value of the Company's stock exceeded the exercise price of the stock option at the date of the grant. The Company recognizes this non-cash stock-based compensation over the respective vesting period, as appropriate. For the years ended December 31, 2005, 2004 and 2003, non-cash stock-based expense of approximately $467,000, $1.5 million, and $2.1 million, respectively, was recorded in the accompanying statement of operations related to these stock options and stock grants.

A summary of the Company's stock options outstanding and exercisable at December 31, 2005, is as follows (shares in thousands):

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| Range of Exercise Prices | Number Outstanding | Weighted-Average Remaining Contractual Life | Weighted-Average Exercise Price | Number Exercisable | Weighted-Average Exercise Price |
| $0.00 - $8.50 | 1,600 | 4.5 | $ 4.97 | 1,600 | $ 4.97 |
| $8.51 - $16.00 | 79 | 6.7 | 15.16 | 53 | 15.16 |
| $16.01 - $24.00 | 1,832 | 7.6 | 20.18 | 655 | 19.05 |
| $24.01 - $32.00 | 2,541 | 8.5 | 27.63 | 574 | 28.20 |
| $32.01 - $35.87 | 136 | 8.4 | 33.96 | 36 | 34.09 |
| | 6,188 | 7.2 | $ 19.55 | 2,918 | $ 13.24 |

*Employee Stock Purchase Plan*

On May 30, 2002, the Company and its shareholders approved and adopted the 2002 Employee Stock Purchase Plan (the "ESPP"). The ESPP authorizes the Company to issue up to 200,000 shares of common stock to its employees who work at least 20 hours per week. Under the ESPP, there are two six-month plan periods during each calendar year, one beginning January 1 and ending on June 30, and the other beginning July 1 and ending on December 31. Under the terms of the ESPP, employees can choose each plan period to have up to 5% of their annual base earnings, limited to $5,000, withheld to purchase the Company's common stock. The purchase price of the stock is 85 percent of the lower of its beginning-of-period or end-of-period market price. Under the ESPP, the Company sold to employees 11,530, 8,792, and 12,777 shares in 2005, 2004, and 2003, respectively. The weighted-average fair value of those purchase rights granted in 2005, 2004, and 2003 was $6.93 per share, $9.04 per share, and $5.27 per share, respectively. As of December 31, 2005, there

were 161,219 shares available for future issuance. In applying the Black-Scholes methodology to the purchase rights granted, the Company used the following assumptions:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| Risk-free interest rate | 3.0% - 3.6% | 1.9% - 2.8% | 1.1% - 1.8% |
| Expected option life | 6 months | 6 months | 6 months |
| Expected price volatility | 39.8% | 50.1% | 54.3% |

The assumed forfeiture rate was not material to the calculation. The Company does not assume a dividend yield as it has never declared or paid cash dividends on its common stock.

## 14. Employee Benefit Plans:

The Company sponsors a defined contribution plan under Section 401(k) of the Internal Revenue Code, which covers U.S. employees who are 21 years of age and over. Under this plan, the Company matches voluntary employee contributions at a rate of 100% for the first 2% of an employee's annual compensation and at a rate of 50% for the next 2% of an employee's annual compensation. Employees vest in the Company's contributions after three years of service with the Company. The Company's expense related to the plan was approximately $940,000, $830,000, and $720,000 in 2005, 2004, and 2003, respectively.

## 15. Commitments and Contingencies:

***Operating Leases***. The Company leases certain equipment and office space under non-cancelable operating leases. Rental expense under operating leases approximated $7.7 million, $6.2 million and $5.0 million for the years ended December 31, 2005, 2004, and 2003, respectively. Future minimum payments, by year and in the aggregate, under non-cancelable operating leases with initial or remaining lease terms of one year or more, are as follows at December 31, 2005 (in thousands):

| | |
|---|---|
| 2006 | $ 6,167 |
| 2007 | 4,515 |
| 2008 | 1,977 |
| 2009 | 553 |
| 2010 | 433 |
| Thereafter | 762 |
| | $ 14,407 |

***Royalty and Consulting Agreements***. The Company has entered into various royalty and other consulting agreements with third party consultants. The Company incurred royalty and consulting expenses of $3.2 million, $5.2 million and $4.4 million during the years ended December 31, 2005, 2004, and 2003, respectively, under minimum contractual obligations that were contingent upon services. The amounts in the table below represent minimum payments to consultants that are contingent upon future services. These fees are accrued when it is deemed probable that the performance thresholds are met. Payments under these agreements for which the Company has not recorded a liability, are as follows at December 31, 2005 (in thousands):

| | |
|---|---|
| 2006 | $ 3,369 |
| 2007 | 431 |
| 2008 | 430 |
| 2009 | 430 |
| 2010 | 330 |
| Thereafter | 1,327 |
| | $ 6,317 |

Portions of the Company’s payments for operating leases and royalty agreements are denominated in foreign currencies and were translated in the tables above based on their respective U.S. dollar exchange rates at December 31, 2005. These future payments are subject to foreign currency exchange rate risk.

***Purchase Obligations***. The Company has entered into certain supply agreements for its products, which include minimum purchase obligations. During the years ended December 31, 2005, 2004, and 2003, the Company paid approximately $6.4 million, $6.4 million, and $6.8 million, respectively, under those supply agreements. The Company’s remaining purchase obligations under those supply agreements are approximately $5.2 million in 2006.

Portions of these payments are denominated in foreign currencies and were translated based on their respective U.S. dollar exchange rates at December 31, 2005. These future payments are subject to foreign currency exchange rate risk.

***Legal Proceedings***. In 2002, pursuant to a purchase and royalty agreement with CERAbio LLC ("CERAbio"), the Company purchased assets consisting primarily of completed technology for $3.0 million and recorded this entire amount as an intangible asset. Of this purchase price, $1.5 million was paid upon signing the purchase agreement. The remaining $1.5 million is recorded in "Accrued expenses and other current liabilities" in the consolidated balance sheet and is payable if certain conditions under the agreement are satisfied. The agreement also provides for specified future royalties contingent upon sales of products related to the acquired technology. Believing that the contractual obligations for payment had not been met, the Company disputed whether the second payment and royalties had been earned. In 2003, CERAbio and Phillips Plastics Corporation filed a lawsuit against the Company in United States District Court for the Western District of Wisconsin for payment of the remaining $1.5 million purchase price and the royalties earned to date. In 2003, the trial court ruled in favor of CERAbio and ordered the Company to pay the remaining purchase price and the royalties earned to date. The royalties earned to date have been recorded within "Accrued expenses and other current liabilities" in the consolidated balance sheet. In 2004, the Company appealed the trial court's judgment to the United States Court of Appeals for the Seventh Circuit. In June 2005, the appeals court upheld the trial court's ruling granting CERAbio summary judgment on certain of the Company's counterclaims, but overruled the trial court's ruling limiting the Company's evidence that it could present at trial. The effect of this ruling was to grant the Company a new trial in this dispute, the date for which has been set as May 8, 2006. The Company does not believe that the outcome of this lawsuit will have a material adverse effect on its financial position or results of operations.

In 2002, the Company entered into a license agreement to resolve an intellectual property dispute that, among other things, provided for a payment of up to $1.25 million if a particular patent re-issued by February 10, 2004, and certain other conditions, as defined in the license agreement, were satisfied. While the patent in question re-issued prior to February 10, 2004, based on its assessment, the Company has concluded that the other required conditions were not satisfied upon re-issuance and the consequential payment of any amount is not probable. On October 12, 2005, the licensor invoked the dispute resolution procedure set forth in the license agreement which provides for a series of informal dispute resolution activities before a more formalized mechanism is invoked which could ultimately lead to a formal arbitration proceeding and potentially an appeal to enforce the judgment of an arbitration panel. The Company continues to believe that the required conditions were not satisfied upon reissuance, and therefore, no additional payment is due as a result of the reissuance. Accordingly, no provision has been made for this contingency as of December 31, 2005.

In 2000, Howmedica Osteonics Corp. ("Howmedica") sued the Company alleging patent infringement. The lawsuit seeks an order of infringement, injunctive relief, unspecified damages and various other costs and relief and could impact a substantial portion of the Company's knee product line. The Company believes, however, that it has strong defenses against Howmedica's claims and thus is vigorously defending this lawsuit. In November 2005, the court issued a Markman ruling on claim construction holding that the Company's products do not literally infringe the claims of Howmedica's patent. No trial date has been set in this matter. Management is unable to estimate the potential liability, if any, with respect to the claims and accordingly, no provision has been made for this contingency as of December 31, 2005. Management believes that the claims are covered in part by our patent infringement insurance. Management does not believe that the outcome of this lawsuit will have a material adverse effect on the Company's financial position or results of operations.

In 2004, the Company announced a voluntary market withdrawal of a limited number of metal acetabular hip cups that are intended for use in the Company's CONSERVE® hip systems. In connection with this market withdrawal, the Company recorded product liability reserves for probable losses related to the market withdrawal. Management believes that the amount recorded is appropriate based on assumptions with respect to estimated patient claims related to the market withdrawal. The nature of a market withdrawal and the associated claims are such that the claims will occur over an extended period of time. The Company's loss estimate includes an assumption for unasserted claims based on management's industry experience with similar circumstances. While the Company believes that the amount recorded related to the market withdrawal is appropriate, it is possible that changes in assumptions related to potential claims or insurance coverage could have an adverse effect on the Company's estimate.

In 1993, prior to the December 1999 recapitalization and inception of the Company in its present form, the Predecessor Company acquired substantially all of the assets of the large joint orthopaedic implant business from Dow Corning Corporation (DCC). DCC retains liability for matters arising from certain conduct of DCC prior to June 30, 1993. As such, DCC has agreed to indemnify the Predecessor Company against all liability for all products manufactured prior to the acquisition except for products provided under the Predecessor Company's 1993 agreement with DCC pursuant to which the Predecessor Company purchased certain small joint orthopaedic implants for worldwide distribution. The Predecessor Company was notified in 1995 that DCC, which filed for reorganization under Chapter 11 of the U.S. Bankruptcy Code, would no longer defend the Predecessor Company in such matters until it received further direction from the bankruptcy court. Based on the most recent plan of reorganization submitted to the court, it appears that the Predecessor Company would be considered an unsecured creditor and, under the terms of the plan, would receive 24% of any such claim as a cash payment with the remainder to be paid by a senior note due within ten years. There are several appeals regarding the confirmed plan of reorganization pending before the U.S. District Court in Detroit, Michigan, which have delayed implementation of the plan. There can be no assurance that DCC will indemnify the Predecessor Company or the Company on any claims in the future. Although neither the Predecessor Company nor the Company maintains insurance for claims arising on products sold by DCC, the Company does not believe the outcome of any of these matters will have a material adverse effect on the Company's financial position or results of operations.

In February 2006, a trial court in France delivered a ruling that requires the Company to pay approximately $1.5 million to one of its French independent sales agents in satisfaction of a dispute, and that also returns control of the underlying sales territory back to the Company. Both parties have the right to appeal this judgment, and the ultimate resolution of this dispute could be an amount higher or lower than this amount. The Company has recorded approximately $1.5 million within "Accrued expenses and other current liabilities" in the consolidated balance sheet. Management believes that the amount recorded is appropriate based on the facts and circumstances of the underlying dispute. The Company does not believe that the ultimate resolution of this dispute will have a material adverse effect on its financial position or results of operations.

The Company is currently involved in separate disputes in Italy with a former agent and two former employees. Management believes that it has meritorious defenses to any claims related to these disputes. The payment of any amount related to these disputes is not probable and cannot be estimated at this time. Accordingly, no provisions have been made for these matters as of December 31, 2005.

In addition to those noted above, the Company is 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 the results of operations or financial position of the Company.

## 16. Segment Data:

The Company has one reportable segment, orthopaedic products, which includes the design, manufacture and marketing of reconstructive joint devices and biologics products. The Company's geographic regions consist of the United States, Europe (which includes the Middle East and Africa) and Other (which principally represents Asia and Canada). Long-lived assets are those assets located in each region. Revenues attributed to each region are based on the location in which the products were sold.

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

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| Net sales by product line: | | | |
| Hips products | $ 109,267 | $ 99,133 | $ 78,071 |
| Knee products | 94,073 | 87,408 | 78,338 |
| Biologics products | 62,358 | 62,070 | 50,056 |
| Extremity products | 40,594 | 36,433 | 31,876 |
| Other | 12,845 | 12,495 | 10,591 |
| Total | $ 319,137 | $ 297,539 | $ 248,932 |
| Net sales by geographic region: | | | |
| United States | $ 197,548 | $ 180,380 | $ 152,864 |
| Europe | 80,374 | 84,726 | 70,078 |
| Other | 41,215 | 32,433 | 25,990 |
| Total | $ 319,137 | $ 297,539 | $ 248,932 |
| Operating income (loss) by geographic region: | | | |
| United States | $ 32,464 | $ 31,209 | $ 18,772 |
| Europe | (5,633) | 3,535 | 7,110 |
| Other | 6,650 | 3,669 | 1,284 |
| Total | $ 33,481 | $ 38,413 | $ 27,166 |

| | December 31, | |
|---|---|---|
| | 2005 | 2004 |
| Long-lived assets: | | |
| United States | $ 58,237 | $ 45,905 |
| Europe | 18,012 | 20,356 |
| Other | 4,957 | 3,946 |
| Total | $ 81,206 | $ 70,207 |

No single foreign country accounted for more than 10% of the Company's total net sales during 2005, 2004 or 2003; however, Italy and France together represented approximately 12% of the Company's total net sales in 2005, and 16% of the Company's total net sales in both 2004 and 2003.

During the year ended December 31, 2005, the Company's European geographic region incurred charges of approximately $1.5 related to the write down of certain inventory due to the termination of an agreement to distribute certain third party spinal products in Europe, charges of approximately $1.5 million associated with a European distributor transition and the associated legal dispute, and charges of approximately $800,000 for severance costs associated with management changes.

## 17. Quarterly Results of Operations (unaudited):

The following table presents a summary of the Company's unaudited quarterly operating results for each of the four quarters in 2005 and 2004, respectively (in thousands). This information was derived from unaudited interim financial statements that, in the opinion of management, have been prepared on a basis consistent with the financial statements contained elsewhere in this filing and include all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of such information when read in conjunction with our audited financial statements and related notes. The operating results for any quarter are not necessarily indicative of results for any future period.

| | 2005 | | | |
|---|---|---|---|---|
| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
| Net sales | $ 82,601 | $ 82,789 | $ 73,479 | $ 80,268 |
| Cost of sales | 22,777 | 24,358 | 20,263 | 24,342 |
| Gross profit | 59,824 | 58,431 | 53,216 | 55,926 |
| Operating expenses: | | | | |
| Selling, general and administrative | 41,668 | 39,183 | 40,045 | 46,020 |
| Research and development | 4,897 | 5,699 | 5,904 | 5,783 |
| Amortization of intangible assets | 1,059 | 1,040 | 1,020 | 1,131 |
| Stock-based expense | 212 | 119 | 65 | 71 |
| Total operating expenses | 47,836 | 46,041 | 47,034 | 53,005 |
| Operating income | $ 11,988 | $ 12,390 | $ 6,182 | $ 2,921 |
| Net income | $ 7,269 | $ 7,767 | $ 3,986 | $ 2,043 |
| Net income per share, basic | $ 0.21 | $ 0.23 | $ 0.12 | $ 0.06 |
| Net income per share, diluted | $ 0.21 | $ 0.22 | $ 0.11 | $ 0.06 |

| | 2004 | | | |
|---|---|---|---|---|
| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
| Net sales | $ 74,917 | $ 75,616 | $ 69,299 | $ 77,707 |
| Cost of sales | 20,386 | 21,383 | 19,998 | 22,416 |
| Gross profit | 54,531 | 54,233 | 49,301 | 55,291 |
| Operating expenses: | | | | |
| Selling, general and administrative | 37,134 | 37,714 | 36,611 | 39,685 |
| Research and development | 4,982 | 4,524 | 4,302 | 4,613 |
| Amortization of intangible assets | 942 | 928 | 975 | 1,044 |
| Stock-based expense | 424 | 465 | 271 | 329 |
| Total operating expenses | 43,482 | 43,631 | 42,159 | 45,671 |
| Operating income | $ 11,049 | $ 10,602 | $ 7,142 | $ 9,620 |
| Net income | $ 6,614 | $ 6,688 | $ 4,430 | $ 6,290 |
| Net income per share, basic | $ 0.20 | $ 0.20 | $ 0.13 | $ 0.19 |
| Net income per share, diluted | $ 0.19 | $ 0.19 | $ 0.13 | $ 0.18 |

The Company's net income for the fourth quarter of 2005 included the after-tax effects of approximately $1.7 million of costs incurred related to management changes in the Company's U.S. and European operations, approximately $1.6 million of charges related to the termination of an agreement to distribute certain third party spinal products in Europe, approximately $1.5 million of charges related to a European distributor transition and the associated legal dispute, and approximately $700,000 of charges to write-down a long-lived asset to its fair value.

The Company's net income for the third quarter of 2004 included the after-tax effect of approximately $800,000 of costs associated with the voluntary market withdrawal of certain CONSERVE® hip components. The Company's net income for the fourth quarter of 2004 included the after-tax effect of approximately $2.9 million of charges associated with the Company's foot and ankle product line transition.

## Management's Annual Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2005, based on the criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this evaluation, our management concluded that our internal control over financial reporting was effective as of December 31, 2005. Our management's assessment of the effectiveness of our internal control over financial reporting as of December 31, 2005, has been audited by KPMG LLP, an independent registered public accounting firm, as stated in their report which is included herein.

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# corporate information

### Investor Relations

Stockholders, securities analysts, and investors seeking more information can access the following information via the Internet at www.wmt.com:

- News releases describing significant company events and sales and earnings results for each quarter and the fiscal year.
- Annual, quarterly, and current reports to the Securities and Exchange Commission describing the company's business and financial condition.

In addition, investors are welcome to call, write or fax Wright to request the information above – including a copy of our annual report or Form 10-K - free of charge. Inquiries should be directed to:

Wright Medical Group, Inc.
Attn: Investor Relations
5677 Airline Road, Arlington, TN 38002
901.867.4113 901.867.4390 Fax

### Transfer Agent and Registrar

American Stock Transfer & Trust Company, Inc. acts as transfer agent and registrar for Wright and maintains all stockholder records for the company. Communications concerning stock holdings, lost certificates, transfer of shares, duplicate mailings or changes of address should be directed to:

Wright Medical Group, Inc.
c/o American Stock Transfer & Trust Company
59 Maiden Lane, New York, NY 10038
800.937.5449 info@amstock.com

### Cash Dividend Policy

Wright has never declared or paid cash dividends on our common stock and does not anticipate a change in this policy in the foreseeable future. The company currently intends to retain all future earnings for the operation and expansion of its business.

### Stock, Price and Trading Holder Data

Wright's common stock is traded on the Nasdaq National Market under the symbol "WMGI." Stock price quotations are available at the Company's investor relations website at www.wmt.com and are printed daily in major newspapers including *The Wall Street Journal*.

The ranges of high and low bid prices per share for the company's common stock for 2005 and 2004 are set forth below.

Price data reflect actual transactions. In all cases, the prices shown are inter-dealer prices and do not reflect markups, markdowns or commissions.

| 2005 | High | Low | 2004 | High | Low |
|---|---|---|---|---|---|
| First Quarter | $27.62 | $24.00 | | $35.53 | $29.24 |
| Second Quarter | $27.97 | $22.98 | | $36.99 | $29.56 |
| Third Quarter | $28.40 | $23.93 | | $36.08 | $22.90 |
| Fourth Quarter | $24.39 | $18.30 | | $30.10 | $20.75 |

As of February 24, 2006, there were 191 stockholders of record and an estimated 7,201 beneficial owners of our common stock.

### Annual Meeting

The 2006 annual meeting of Wright stockholders will be held
May 11, 2006
beginning at 3:30pm CST at the
Doubletree Hotel
Executive Meeting Room
5069 Sanderlin Avenue
Memphis, TN 38117

The Notice of Annual Meeting and Proxy Statement are being mailed to shareholders with this annual report.

### Independent Auditors

KPMG LLP
Memphis, Tennessee

**Non-GAAP Financial Measures**

The Company uses non-GAAP financial measures, such as net sales, excluding the impact of foreign currency, gross profit, as adjusted, operating income, as adjusted, net income, as adjusted and net income, as adjusted, per diluted share. The Company's management believes that the presentation of these measures provides useful information to investors. These measures may assist investors in evaluating the Company's operations, period over period. The measures exclude such items as business development activities, including purchased in-process research and development, the financial impact of significant litigation, and stock-based expense recorded pursuant to FASB statement No. 123R, all of which may be highly variable, difficult to predict and of a size that could have substantial impact on the Company's reported results of operations for a period. Management uses these measures internally for evaluation of the performance of the business, including the allocation of resources and the evaluation of results relative to employee performance compensation targets. Investors should consider these non-GAAP measures only as a supplement to, not as a substitute for or as superior to, measures of financial performance prepared in accordance with GAAP. This annual report includes discussion of non-GAAP financial measures. Reference is made to the most directly comparable GAAP financial measures. The reconciliation of the differences between the two financial measures is found on the initial page of this annual report, and is otherwise available in the "Corporate - Investor Information – Supplemental Financial Information" section of the Company's website located at www.wmt.com.


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