

Cardo Medical, Inc.  
Form 10-K  
March 31, 2011

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

(Mark One)

- Annual report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934  
For the fiscal year ended **December 31, 2010**
- Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number **0-21419**

CARDO MEDICAL, INC.

(Exact name of registrant as specified in its charter)

Delaware 23-2753988

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

7625 Hayvenhurst Avenue, Suite #49, Van Nuys, CA 91406

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: **(818) 780-6677**

Securities registered pursuant to Section 12(b) of the Exchange Act: **None**

Securities registered pursuant to Section 12(g) of the Exchange Act:

Common Stock, \$0.001 par value per share

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes

No

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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

|   |                          |                          |                                     |
|---|--------------------------|--------------------------|-------------------------------------|
| Large accelerated filer                       | Accelerated filer        | Non-accelerated filer    | Smaller reporting company           |
| <input type="checkbox"/>                      | <input type="checkbox"/> | <input type="checkbox"/> | <input checked="" type="checkbox"/> |
| (Do not check if a smaller reporting company) |                          |                          |                                     |

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the average bid and asked price of such common equity, as of June 30, 2010, was \$45,935,639.

As of March 18, 2011 there were 230,293,141 shares of Common Stock, \$0.001 par value per share, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Part III of this Annual Report on Form 10-K is incorporated by reference to our Definitive Proxy Statement on Schedule 14A to be filed in respect of our 2011 Annual Meeting of Stockholders.

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CARDO MEDICAL, INC.  
FORM 10-K ANNUAL REPORT  
FOR THE YEAR ENDED DECEMBER 31, 2010  
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## Item 1. Business

The following business description should be read in conjunction with the consolidated financial statements and notes thereto appearing elsewhere in this Annual Report on Form 10-K.

### Organization

#### Overview

Cardo Medical, Inc., which we refer to as Cardo, the Company, we, us or our, is an orthopedic medical device company specializing in designing, developing and marketing high performance reconstructive joint devices and spinal surgical devices. Reconstructive joint devices are used to replace knee, hip and other joints that have deteriorated through disease or injury. Spinal surgical devices involve products to stabilize the spine for fusion and reconstructive procedures. Within these areas, we are focused on developing surgical devices, instrumentation and techniques that will enable surgeons to move what are typically inpatient surgical procedures to the outpatient world. We commercialize our reconstructive joint devices through our reconstructive division and our spine devices through our spine division.

In December 2006, we initiated a limited release and began sales of the Align 360™ unicompartmental knee device, a partial knee resurfacing device for the medial or lateral part of the knee. Since then, we have received approval under Section 510(k) of the Federal Food, Drug and Cosmetic Act, which we refer to as Section 510(k), for the following:

- Uniquely instrumented patellofemoral arthroplasty, a resurfacing device for the back of the kneecap and distal femur;
- Total knee system which has both a posterior cruciate sacrificing as well as a posterior cruciate sparing component design;
- Total hip replacement system along with its monopolar and bipolar hip systems; and
- Spinal lumbar fusion system and its cervical plate and screw systems.

#### Recent Developments

On October 7, 2010, the Company's management and Board of Directors decided to put substantially all of its assets up for sale. The assets determined to be held for sale were inventories, intellectual property, and property and equipment of its reconstructive products, which we refer to as the Reconstructive Division, and spine products, which we refer to as the Spine Division. The Company decided to put up for sale the assets of its Reconstructive Division and Spine Division primarily because it did not have sufficient working capital, and was not able to procure such financial resources through equity or debt financing, in order to fully execute a profitable sales strategy.

As a result of the level of our available funds and the projection that the amount of available funds would be insufficient to meet all of our working capital needs for the next twelve months, our management undertook the following additional cost-reduction measures during October and November 2010:

- it terminated over half of the Company's employees;
- had the Company's Chief Executive Officer and President forgo their salaries;
- reduced office space by not renewing the corporate headquarters facility lease;

- scaled back research and development activities; and
- deferred manufacturing of inventories required to build additional base-level implant banks.

On January 24, 2011, we entered into an Asset Purchase Agreement with Arthrex, Inc., which we refer to as Arthrex, pursuant to which we have agreed to sell the assets of the Reconstructive Division, to Arthrex in exchange for cash consideration of approximately \$9.9 million, plus the value of our inventory and property and equipment relating to the Reconstructive Division calculated as of the closing date, which we refer to as the Asset Purchase Agreement. The Asset Purchase Agreement also provides for us to receive royalty payments equal to 5% of net sales of our products made by Arthrex on a quarterly basis for a term up to and including the 20th anniversary of the

closing date. Following the execution of the Asset Purchase Agreement, Arthrex delivered to us a \$250,000 deposit to be credited against the cash consideration due at closing. From the cash consideration paid at closing, \$900,000 will be deposited with an escrow agent for a period of twelve months from the closing date to be used for any adjustments to the value of our inventory and property, plant and equipment relating to the Reconstructive Division and for post closing indemnification claims which may be asserted by Arthrex with respect to unassumed liabilities. We estimate that the value of our inventory and property, plant and equipment relating to the Reconstructive Division as of the closing date will be approximately \$4.7 million. The Asset Purchase Agreement provided for the transaction to be completed by April 24, 2011, which we refer to as the End Date. If the transaction is not completed by the End Date, Arthrex, under certain circumstances, can terminate the Asset Purchase Agreement.

On March 18, 2011, we entered into the First Amendment to the Asset Purchase Agreement, dated as of January 24, 2011, with Arthrex. The first amendment modifies the definition of "End Date" so that it means May 24, 2011; provided that if (i) the closing has not occurred by reason of the failure to satisfy the condition in the Asset Purchase Agreement that at least 20 calendar days have passed since an Information Statement has been filed with the SEC and transmitted to every record holder of our shares, but (ii) the SEC has cleared our responses to the SEC's comment letter and no unresolved comments are pending before the SEC with respect to the Information Statement on or before such date, then the End Date shall be June 24, 2011. Pursuant to the terms of the Asset Purchase Agreement, Arthrex can terminate the Asset Purchase Agreement if certain conditions have not been fulfilled or waived by the End Date.

On March 18, 2011, we executed a Secured Promissory Note in favor of Arthrex, which we refer to as the Arthrex Note. Under the terms of the Arthrex Note, the \$250,000 deposit made by Arthrex on January 24, 2011 pursuant to the terms of the Asset Purchase Agreement constitutes an initial loan. Under the terms of the Arthrex Note, Arthrex will (a) make a second loan to us of such amount to repay the indebtedness owed to Jon Brooks in the principal amount of \$300,000 plus all accrued and unpaid interest thereon, which we refer to as the Brooks Note, and the indebtedness owed to Earl Brien, M.D. in the principal amount of \$200,000 plus all accrued and unpaid interest thereon, which we refer to as the Brien Note, and (b) make additional advances within two business days of our written request; provided that in no event shall the aggregate principal amount loaned under the Arthrex Note at any time exceed \$1,250,000. The proceeds obtained by us under the Arthrex Note were used to pay off the Brooks Note and the Brien Note and satisfy all obligations under the Brooks Note and the Brien Note and the security agreements relating to such indebtedness totaling \$522,000 on March 18, 2011. The proceeds obtained from additional drawdowns can be used for ordinary course working capital needs of our Reconstructive Division. As of March 22, 2011, we have borrowed an additional \$450,000 which we utilized to pay for vendors of inventory resulting in total borrowings under the Arthrex Note of \$972,000. Pursuant to the Arthrex Note, we granted, pledged and assigned to Arthrex a security interest in all of our assets, which security interest shall rank senior to and have priority over those held by all other creditors.

We expect to close the transactions contemplated by the Asset Purchase Agreement with Arthrex during the second quarter of 2011. We, however, remain in negotiations to sell substantially all of the assets of our Spine Division. Management anticipates that the sale of substantially all of the assets of our Spine Division will be completed during the second quarter of 2011.

#### Nature of Business

As discussed above, we determined in October 2010, to put substantially all of our assets up for sale. We expect to close the sale of the Reconstructive Division assets contemplated by the Asset Purchase Agreement with Arthrex during the second quarter of 2011. We remain in negotiations to sell substantially all of the assets of our Spine Division and we anticipate that this will also be completed during the second quarter of 2011. Upon the sale of the Reconstructive Division assets and the Spine Division assets, we will continue to be a public company and our common stock will continue to trade on the Over-the-Counter Bulletin Board. We intend to use the proceeds from these sales to pay: (i) accrued salaries and payroll taxes, (ii) transaction expenses, and (iii) for working capital purposes.

After the sale of substantially all of our Reconstructive Division assets and our Spine Division assets, our ongoing operations will consist of any remaining assets, the collection of accounts receivable, the collection of royalty

payments pursuant to the terms of the Asset Purchase Agreement with Arthrex, and the payment of any liabilities. Following the sale of our Reconstructive Division assets and/or our Spine Division assets, we may elect to acquire another entity or invest the net proceeds from the sale of the Reconstructive Division assets and/or our Spine Division assets in such manner as is determined by our Board of Directors and management.

The following is a discussion of the nature of our business on a historical basis, including for the year ended December 31, 2010.

We develop and distribute high performance reconstructive orthopedic and spinal surgery products to various medical organizations. We are focused on moving surgical procedures which have been traditionally performed in a hospital inpatient environment to an outpatient setting by providing better instrumentation, which encourages facile surgical techniques and less intimidation to surgeons. We work in small, focused development teams in conjunction with leading surgeons to rapidly develop products from conception to launch. We launched and commenced clinical usage on a limited basis of our first product, a high performance, unicompartamental knee replacement, in late 2006. Up until October 2010, we had engaged in an aggressive and focused research and development program to fill out our product portfolio since our uni- knee introduction. We have developed a complete line of FDA-approved and market ready knee reconstruction and total hip product lines which promote unique procedural innovations. Additionally, we now have an FDA approved, competitive portfolio of products for cervical and lumbar fusion surgery. Our Spine Division has a robust pipeline of novel products at various stages of development for future release. Counter to traditional innovation companies, we are focused on procedural innovations where often the technique is developed first with novel instrumentation and a simpler surgical approach, with the implant being developed secondarily.

See Note 9 to our consolidated financial statements included in Item 8 of this Annual Report on Form 10-K for information regarding our operating segments.

## Products

The following is a listing of our product portfolio:

### Knee Portfolio

Our knee portfolio has been designed to create a system which allows surgeons to view knee procedures as a "remodeling" of the joint. The surgeon can choose to remodel either the medial or lateral compartment, the patellofemoral joint, a combination thereof, or a full knee "remodeling". Our full knee system is bone conserving and thin which creates an aesthetically pleasing x-ray.

- **Align 360™ Unicompartamental Knee System**

- A uniquely instrumented high performance partial knee replacement that allows resurfacing of either the medial or lateral compartments of the knee. This product promotes the consistent balancing of the flexion and extension gaps for unicompartamental knee surgery. The system reduces intimidation factor for new surgeons, is simple to utilize, creates an easy and reproducible outcome without any capital cost outlays by the hospital to allow surgeons to perform this procedure.

- **Align 360™ Patellofemoral System**

- A uniquely instrumented and novel patellofemoral system that allows resurfacing of the patellofemoral joint. This product is an anatomic system that addresses the disease of the patellofemoral joint. The instrumentation system for this is novel, simple, reproducible and reduces intimidation factor for surgeons. The patellofemoral system is designed to work in conjunction with our unicompartamental system which allows surgeons to address patients with bi-compartmental disease by preserving ligaments, both anterior and posterior cruciate ligaments.

- **Align 360™ Total Knee System**

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- A uniquely instrumented high performance total knee system consisting of posterior-stabilized and cruciate retaining femoral components.

## Hip Portfolio

- Cardo Total Hip System

- A taperloc type of hip system that allows replacement of the ball and socket of the hip joint. This product offers a dual taper hip design for total hip arthroplasty complemented by our Bipolar and Monopolar Hip Systems for hip fracture applications.

- Cardo Bipolar Hip System

- A bipolar hip that allows replacement of the ball of the hip from either fracture, tumors or reconstruction from some other type of pathology.

- Cardo Monopolar Hip System

- A monopolar hip that allows replacement of the ball of the hip from either fracture, tumors or reconstruction from some other type of pathology.

## Spinal Product Line

- Cardo Lumbar Pedicle Screw/Rod System

- A pedicle screw and rod system for instrumentation of lumbar spine fusion incorporating an evolutionary locking mechanism allowing for high screw angulation.

- Cardo Cervical Plate/Screw System

- An innovative low-profile system for cervical spine fusion incorporating an integrated, floating tapered-ring locking mechanism to simplify surgical procedure.

- Cardo Intervertebral System

- A PEEK system offering uniquely wide openings to allow for optimal bone graft delivery and fusion.

Our products listed above have received Section 510(k) approval. We have a number of earlier stage research and development projects, some of which have received Section 510(k) approval and others that may be submitted for regulatory approval in the future. Several of these projects involve alternative bearing surfaces for arthroplasty.

## Orthopedic Industry

According to the 2008-2009 Orthopaedic Industry Annual Report published by Orthoworld, Inc., which we refer to herein as the Industry Annual Report, the worldwide market for orthopedic products in 2008 was estimated to be \$35.7 billion, representing an 9.9% increase from the previous year. According to this report, more than 90 percent of joint replacements are performed on people over the age of 45. With a predicted growth of three percent for the elderly population (65+) and a similar growth rate among those aged 45-64, the report suggests that demographics alone will drive growth in the global orthopedic industry. We also believe that the orthopedic industry will continue to grow due to an increasingly older population and extended life spans in the United States and other developed countries worldwide.

According to the Industry Annual Report, the world's seven largest joint replacement companies (and the only ones with global joint replacement sales in excess of \$200 million) - Zimmer, Johnson & Johnson, Stryker, Smith & Nephew, Biomet, Wright Medical and Aesculap - generated 91% of hip, knee, shoulder and other joint product sales in 2008. We believe that the size of these companies often leads them to concentrate their marketing and research and development efforts on products that they believe will have a relatively high minimum threshold level of sales. As a

result, there is an opportunity for a smaller orthopedic company, such as ours, to focus on smaller, higher-growth sectors of the orthopedic market, while still offering a comprehensive product line to address the needs of its customers in a customized and interactive fashion.

Orthopedic devices are commonly divided into several primary sectors corresponding to the major subspecialties within the orthopedic field: reconstruction, trauma, arthroscopy, spine and biologics. Management's initial focus is on innovation related to reconstructive joint devices and spinal products, as discussed below.

#### Reconstructive Joint Device Market

Most reconstructive joint devices are used to replace or repair joints that have deteriorated as a result of disease or injury. Despite the availability of non-surgical treatment alternatives such as oral medications, injections and joint fluid supplementation, severe cases of disease or injury often require reconstructive joint surgery.

Reconstructive joint surgery involves modifying the bone area surrounding the affected joint and inserting one or more manufactured components, and also may involve using bone cement.

The reconstructive joint device market is generally divided into the areas of hips, knees and extremities. According to the Industry Annual Report, it is estimated that the worldwide reconstructive joint device market had sales of approximately \$12.7 billion in 2008, an increase of nearly 10% over sales in 2007, with hip and knee reconstruction representing the largest sectors.

#### Knee Reconstruction.

The knee joint involves the surfaces of three distinct bones: the lower end of the femur, or thigh bone, the upper end of the tibia, or shin bone, and the patella, or kneecap. Cartilage on any of these surfaces can be damaged due to disease or injury, leading to pain and inflammation requiring knee reconstruction. According to the Industry Annual Report, knee reconstruction was the largest sector of the reconstructive joint device market in 2008, with estimated sales of approximately \$6.5 billion worldwide.

One of the major trends in knee reconstruction includes the use of minimally invasive techniques to accomplish reconstructive goals with less damage to surrounding soft tissues. Our uni-compartmental device has been designed to be inserted through small incision surgery with an innovative instrumentation approach. Our design approach was to develop an innovative instrumentation system to improve and simplify surgical technique for a clinically proven implant concept. We believe that our system allows the surgeon to simply and reproducibly balance both flexion and extension gaps. This is a general approach we plan to continue with our other products.

#### Hip Reconstruction.

The hip joint is a ball-and-socket joint that enables the large range of motion that the hip performs in daily life. The hip joint is most commonly replaced due to degeneration of the cartilage between the head of the femur (the ball) and the acetabulum or hollow portion of the pelvis (the socket). This degeneration causes pain, stiffness and a reduction in hip mobility. According to the Industry Annual Report, it is estimated that the worldwide hip reconstruction market had sales of approximately \$5.4 billion in 2008.

Similar to the knee reconstruction market, major trends in hip replacement procedures and implants are to extend implant life and to preserve bone stock for possible future procedures. New products have been developed that incorporate advances in bearing surfaces from the traditional polyethylene surface. These alternative bearing surfaces include metal-on-metal, cross-linked polyethylene and ceramic-on-ceramic combinations, which exhibit improved wear characteristics and lead to longer implant life. In addition to advances in bearing surfaces, implants that preserve more natural bone have been developed in order to minimize surgical trauma and recovery time for patients. These implants, known as bone-conserving implants, leave more of the hip bones intact, which may be beneficial given the likelihood of future revision replacement procedures as the average patient's lifetime increases. Bone-conserving procedures are intended to enable patients to delay their first total hip procedure and may significantly increase the time from the first procedure to the time when a revision replacement implant is required. Our hip product portfolio, currently consisting of three products, is focused on improving the surgical techniques for bone-conservative procedures. These products integrate implant designs that are based on predicate devices (i.e., a device with a similar design that has already received clearance) with successful long-term clinical histories. Up until October 2010, we had been actively engaged in several research and development efforts to develop better instrumentation for less traumatic surgeries, improved component designs and bearing surfaces to increase longevity of our devices.

#### Spine Market

Back and neck pain is one of the leading causes of healthcare expenditures in the United States, with a direct cost of approximately \$86 billion annually for diagnosis, treatment and rehabilitation, according to an article published in The Journal of the American Medical Association (published February 13, 2008). According to the Industry Annual Report, sales of spine products in the U.S. market for 2008 totaled \$4.6 billion and \$6.5 billion worldwide, an increase of 13% in global revenues over 2007. This report continues to state that growth in the last two years has slowed dramatically from the 20+ percent increases experienced in the early 2000's.

The spine consists of vertebrae, which are 29 separate bones connecting the skull to the pelvis. The vertebrae are joined together by soft tissue structures that provide the core of the human skeleton. Within the spinal column, the spinal cord, which is the body's central nerve pathway, is protected by the bony parts of the vertebrae. Nerves contained in the spinal column exit through the foramen openings to the rest of the body. Vertebrae are joined to each other in pairs which are often referred to as motion segments. These motion segments move by means of three

joints: two facet joints and one spine disc. The facet joints provide stability and enable the spine to bend and twist while the discs absorb pressures and shocks to the vertebrae.

The four major categories of spine disorders are degenerative conditions, deformities, trauma and tumors. The largest market, and the focus of our spinal research and development business, is degenerative conditions of the facet joints and disc space. These conditions can result in instability and pressure on the nerve roots as they exit the spinal column, causing back pain or radiating pain in the arms or legs.

The recommended treatments for spine disorders depend on the severity and duration of the disorder. Initially, physicians will prescribe non-operative procedures, including bed rest, bracing, medication, lifestyle modification, exercise, physical therapy, chiropractic care and steroid injections. In most cases, non-surgical treatment options are effective; however, many patients do not respond to non-operative treatments and require spine surgery to alleviate their symptoms.

It is estimated that in excess of one million patients undergo spine surgery each year in the United States. The most common spine surgery procedures are: discectomy, which consists of the removal of all or part of a damaged disc; laminectomy, the removal of all or part of a lamina, or thin layer of bone, to relieve pinching of the nerve and narrowing of the spinal canal; and fusion, where two or more adjoining vertebrae are fused together to provide stability. All three of these procedures require access to the spine through either a traditional open approach or through smaller, less invasive methods using various types of retractors or other percutaneous techniques.

We believe that the implant market for spine surgery procedures will continue to grow because of the following market dynamics:

#### Demographics.

The population most likely to experience back pain is likely to grow as a result of our aging baby boomer population. The first baby boomers turned 62 in 2008, and over the next two decades we will see a substantial increase in our aging population. We believe that this generation of older people is less willing to compromise on reducing activity levels and is more interested in treatments that will allow a more rapid return to activities with shorter periods of disability.

#### Increased Acceptance of Implants.

The implementation of implants for use in spine surgery has become the standard of care over the past decade. In the last five years, there has been a substantial and significant increase in the percentage of spinal fusion surgeries using implants. According to Millennium Research Group, an estimated 85% or more of all spinal fusion procedures involve an implant. The current generation of modern trained spine surgeons has accepted usage of implants as the gold standard for achieving optimal results.

#### Increased Demand for Newer Technologies

. Because of the ubiquitous nature of back pain, the market is interested in newer technologies, such as motion preservation, and novel minimally invasive techniques which would potentially allow earlier intervention in the degenerative process of the spine for many patients.

#### Acquisitions

Cardo Medical, LLC, which we refer to as Cardo LLC, was formed on April 6, 2007 as a California limited liability company for the purpose of acquiring an interest in the medical device business conducted by Accin Corporation directly and through Accin's interests in Cervical Xpand, LLC and Uni-Knee, LLC. Following Cardo LLC's organization:

- Cardo LLC and Accin formed a Delaware limited liability company on April 20, 2007 under the name Accelerated Innovation, LLC;

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- On May 21, 2007, Accin contributed substantially all of its business, properties and assets, including its majority interests in Cervical Xpand and Uni-Knee, to Accelerated Innovation in exchange for a 62.5% interest in Accelerated Innovation and the distribution referenced below in the amount of \$3.75 million;
- Concurrently with the above, on May 21, 2007, Cardo LLC contributed \$3.75 million to Accelerated Innovation in exchange for a 37.5% interest in Accelerated Innovation; and
- The amount of \$3.75 million was distributed by Accelerated Innovation to Accin.

Under the terms of Accelerated Innovation's Limited Liability Company Agreement, Cardo LLC was granted an option to purchase the 62.5% interest in Accelerated Innovation held by Accin for a purchase price of \$6.25 million. Following the exercise of that option in June 2008, Cardo LLC acquired all of the interests in Accelerated Innovation held by Accin, and Accelerated Innovation became a wholly-owned subsidiary of Cardo LLC.

Prior to that, in February 2008, Cardo LLC entered into Membership Interest Purchase Agreements with the holders of the minority membership interests in Cervical Xpand and Uni-Knee. Cervical Xpand and Uni-Knee were formed as New Jersey limited liability companies on July 12, 2005 and May 10, 2006, respectively, for the purpose of conducting research and development activities. Prior to the closing of the transactions contemplated by the Membership Interest Purchase Agreements, Accelerated Innovation, as the assignee of Accin's assets, owned 52.083% of the membership interests in Cervical Xpand and 51.21% of the membership interests in Uni-Knee, and the minority holders held the remaining outstanding interests. Upon the closing of the transactions contemplated by the Membership Interest Purchase Agreements, in June 2008, Cardo LLC acquired the outstanding membership interests from the minority holders for an aggregate purchase price of \$1,437,510 for the Cervical Xpand interests and \$2,049,180 for the Uni-Knee interests. As a result, Cardo LLC owned all of the interests in Cervical Xpand and Uni-Knee directly and indirectly through its ownership of Accelerated Innovation.

On June 18, 2008, Cardo LLC entered into a Merger Agreement and Plan of Reorganization with clickNsettle.com, Inc., which we refer to as CKST, and Cardo Acquisition, LLC, a California limited liability company and wholly-owned subsidiary of CKST. Upon the consummation of the transactions contemplated by the Merger Agreement, CKST acquired Cardo LLC through a merger of Cardo LLC with Cardo Acquisition, with Cardo LLC continuing as the surviving entity in the merger and a wholly-owned subsidiary of CKST. Pursuant to the Merger Agreement, all of the issued and outstanding units of Cardo LLC's membership interests were converted into the right to receive shares of the common stock of CKST.

On or about the signing of the Merger Agreement with CKST, Frost Gamma Investments Trust and other investors invested \$12,975,000 in Cardo LLC in exchange for units of Cardo LLC's membership interests. Dr. Phillip Frost, Chairman and Chief Executive Officer of Opko Health, Inc. and non-executive Chairman of the Board of Directors of Teva Pharmaceutical Industries Limited, is the trustee and beneficiary of Frost Gamma Investments Trust. Cardo LLC used approximately \$9.7 million of the proceeds from these investments to close on the acquisition of the outstanding equity interests of three partially owned subsidiaries of Cardo LLC (Accelerated Innovation, LLC, Cervical Xpand, LLC and Uni-Knee, LLC), to repay an existing member loan (in the amount of \$1.2 million) and for transaction expenses, and used the remaining funds to accelerate its research and product development.

Under the terms of the Merger Agreement with CKST, at the closing of the merger, each Cardo LLC unit of membership interest issued and outstanding was converted into and exchanged for the right to receive 667,204.70995 shares of common stock of CKST. As a result of the merger with CKST, CKST's stockholders and optionholders owned approximately 5.5% of the combined company on a fully diluted basis (or 11,298,979 shares of common stock outstanding and underlying options), the members of Cardo LLC, excluding the new investors, owned approximately 64.8% of the combined company on a fully diluted basis (or 133,440,942 shares of common stock), the new investors owned approximately 28.5% of the combined company on a fully diluted basis (or 58,641,701 shares of common stock), and optionholders of Cardo LLC owned approximately 1.2% of the combined company on a fully diluted basis (or 2,398,400 shares of common stock underlying those options).

Following the closing of the merger with CKST, each of Cervical Xpand, Uni-Knee and Accelerated Innovation merged with and into Cardo LLC, which is now the sole subsidiary of the Company and Cardo LLC converted into a Delaware limited liability company.

We are headquartered in Van Nuys, California. In connection with the consummation of the merger with CKST, CKST approved through its stockholders an amendment to its Amended and Restated Certificate of Incorporation to change its name from "clickNsettle.com, Inc." to "Cardo Medical, Inc." CKST's trading symbol was "CKST.OB,"

which has changed to "CDOM.OB" in connection with the name change. Cardo Medical's common stock is quoted on the National Association of Securities Dealers, Inc.'s, Over-the-Counter Bulletin Board, or the OTC Bulletin Board.

## Government Regulation

### United States

Health care, in general, is a highly regulated industry with various state and federal laws and regulations having particular application to the Company. Our products are principally regulated by the U.S. Food and Drug Administration, or the FDA, under the Federal Food, Drug, and Cosmetic Act, which we refer to as the Act. Some of our products are also regulated by state agencies under laws similar to their federal FDA counterparts. FDA regulations and the requirements of the Act affect the pre-clinical and clinical testing, design, manufacture, safety, efficacy, labeling, storage, recordkeeping, advertising and promotion of our medical device products. FDA regulations govern, among other things, the following activities that we or our partners perform and will continue to perform:

- *product design and development;*
- *product testing;*
- *product manufacturing;*
- *product labeling;*
- *product storage;*
- *premarket clearance or approval;*
- *advertising and promotion; and*
- *product sales and distribution.*

Generally, before we can market a new medical device, marketing clearance from the FDA must be obtained through either the pre-market notification process under Section 510(k) of the Act or through application for a pre-market approval, or PMA, under Section 515 of the Act. The FDA typically grants a Section 510(k) clearance if the applicant can establish that the device is substantially equivalent to a predicate device (i.e., a device with a similar design that has already received clearance). It generally takes approximately three months from the date of a Section 510(k) submission to obtain clearance, but it may take longer, particularly if a clinical trial is required. The FDA may find that a Section 510(k) clearance is not appropriate or that substantial equivalence has not been shown and, as a result, will require a PMA application.

PMA applications must be supported by valid scientific evidence to demonstrate the safety and effectiveness of the device, typically including the results of human clinical trials, bench tests and laboratory and animal studies. The PMA application also must contain a complete description of the device and its components, and a detailed description of the methods, facilities and controls used to manufacture the device. In addition, the submission must include the proposed labeling and any training materials. The PMA application process can be expensive and generally takes significantly longer than the Section 510(k) process. Additionally, the FDA may never approve the PMA application. As part of the PMA application review process, the FDA generally will inspect the manufacturer's facilities to ensure compliance with applicable quality system regulatory requirements, which include quality control testing, control documentation and other quality assurance procedures.

If human clinical trials of a medical device are required and the device presents a significant risk, the sponsor of the trial must file an investigational device exemption, or IDE, application prior to commencing human clinical trials. The IDE application must be supported by data, typically including the results of animal and/or laboratory testing. If the IDE application is approved by the FDA and one or more institutional review boards, human clinical trials may begin at a specific number of investigational sites with a specific number of patients, as approved by the FDA. If the device presents a non-significant risk to the patient, a sponsor may begin the clinical trial after obtaining approval for the trial by one or more institutional review boards without separate approval from the FDA. Submission of an IDE does not give assurance that the FDA will approve the IDE and, if it is approved, we cannot assure you that the FDA will determine that the data derived from the trials support the safety and effectiveness of the device or warrant the continuation of clinical trials. An IDE supplement must be submitted to and approved by the FDA before a sponsor or investigator may make a change to the investigational plan that may affect its scientific soundness, study indication or the rights, safety or welfare of human subjects. The trial also must comply with the FDA's IDE regulations and

informed consent must be obtained from each subject.

If the FDA determines that we are not in compliance with the law, it can institute proceedings to detain or seize products, issue a market withdrawal, enjoin future violations and seek civil and criminal penalties against us and our officers and employees. If we fail to comply with these regulatory requirements, our business, financial condition and results of operations could be harmed.

Thus far, all of our approved products have been cleared by the FDA through the Section 510(k) pre-market notification process. We have not needed to conduct any clinical trials in order to support our regulatory approvals. Regulations regarding the manufacture and sale of our products are subject to change. We cannot predict the effect, if any, that these changes might have on our business, financial condition and results of operations. In addition to granting approvals for our products, the FDA has the authority to randomly inspect us for compliance with regulatory requirements that apply to our operations. These requirements include labeling regulations, manufacturing regulations, quality system regulations, regulations governing unapproved or off-label uses and medical device regulations. Medical device regulations require a manufacturer to report to the FDA serious adverse events or certain types of malfunctions involving its products. The FDA inspects device and drug manufacturing facilities in the United States in order to assure compliance with applicable quality system regulations. As discussed in the section below titled "Manufacturing and Supply," we currently outsource the manufacture of our products to third-party vendors.

Further, we are subject to various federal and state laws concerning health care fraud and abuse, including false claims laws, anti-kickback laws and physician self-referral laws. Violations of these laws can result in criminal and/or civil punishment, including fines, imprisonment and, in the United States, exclusion from participation in government health care programs. The scope of these laws and related regulations is expanding and their interpretation is evolving and subject to change. Increased enforcement of these laws and regulations has resulted in greater scrutiny of marketing practices in our industry. If a governmental authority were to determine that we do not comply with these laws and regulations, then we and our officers and employees could be subject to criminal and civil sanctions, including exclusion from participation in federal health care reimbursement programs. This could also effect the manner in which our products are marketed and the manner in which we would conduct business.

#### Health Care Reform Laws

In 2010, Congress enacted significant health care reform legislation, specifically, the "Patient Protection and Affordable Care Act" and the "Health Care and Education Reconciliation Act," which legislation is now law. This legislation is considered by some to be the most dramatic change to the country's health care system in decades.

The principal aim of these laws is to expand health insurance coverage to approximately 32 million Americans who are currently uninsured. The law's most far-reaching changes do not take effect until 2014, including a requirement that most Americans carry health insurance. The consequences of these significant coverage expansions on the sales of the Company's products are unknown and speculative at this point.

These laws contain many provisions designed to generate the revenues necessary to fund the coverage expansions. The provisions which are most directly relevant to the Company are those that impose fees or taxes on certain health-related industries, including medical device manufacturers.

Beginning in 2013, each medical device manufacturer will have to pay an excise tax (or sales tax) in an amount equal to 2.3 percent of the price for which such manufacturer sells its medical devices. This tax applies to all medical devices, including the Company's products and product candidates. The effect, if any, of such tax on future sales is speculative.

Additionally, these laws also provide for increased enforcement of the fraud and abuse regulations previously mentioned, which may result in higher compliance-related costs.



The constitutionality of these laws is currently in dispute and several lawsuits have been filed in federal courts throughout the country. The rulings on enforceability of these laws have differed between the various courts and many are currently on appeal. The timing associated with the final resolution of those appeals is unknown at this time. Many legal scholars opine that the issue will ultimately have to be decided by the U.S. Supreme Court. In the interim, the laws currently remain in effect. Adverse rulings regarding these laws have been stayed pending appeal.

#### Research and Development

Our research and development engineering personnel have extensive experience in developing medical devices to treat joint and spine pathologies. Our engineers work closely with surgeons to design devices that are intended to improve patient care, simplify surgical techniques and reduce overall costs. In addition to constantly enhancing and improving our current product offerings, we historically focused our research and development efforts in novel approaches to total knee arthroplasty, spinal motion preservation devices and products that promote new fusion techniques and minimally invasive surgical techniques for reconstructive and spinal surgery.

We currently do not have any formal consulting arrangements with our surgeons. However, we work with surgeons informally to obtain their feedback to enhance our products and to identify product candidates that we would like to develop. We historically have worked closely with product opinion leaders to develop and enhance our product portfolio. During the years ended December 31, 2010 and 2009, we spent approximately \$859,000 and \$1,003,000, respectively, on research and development.

Due to the decision made in October 2010 to sell substantially all of the assets of the Company, we scaled back research and development activities and expect research and development expenses to be minimal in the future.

#### Manufacturing and Supply

We do not have a manufacturing facility, and we currently do not intend to build manufacturing facilities of our own in the foreseeable future. We utilize third-party vendors to manufacture all of our implants and instruments, including components of our products, while internally performing product design and quality assurance. We currently use a variety of manufacturers for our devices.

Our outsourced manufacturing process typically involves machining semi-completed raw materials for both our metal and polyethylene components that make up our joint replacement systems. After being machined, the parts are inspected and processed in preparation for final polishing and finishing as needed. Prior to being packaged, our parts are inspected again to ensure that they are within approved specifications. We also use components in our devices that we acquire from other companies. We distribute both sterile and non-sterile implants and instruments.

Our outsourcing strategy is targeted at companies that meet FDA Quality Standards and our internal policies and procedure standards. Supplier performance is maintained and managed through a corrective action program intended to ensure that all product requirements are met or exceeded. We believe these manufacturing relationships minimize our capital investment, help control and reduce costs and allow us to compete with larger volume manufacturers and sellers of spine surgery and reconstructive surgical products.

We currently utilize a variety of manufacturers for our products and rely on a limited number of sources for our product components that are manufactured by third parties. In the future, we may consider manufacturing certain products or product components internally, if and when demand or quality requirements make it appropriate to do so.

Although we believe that alternative third-party manufacturers are available, we cannot assure you that we will be able to timely replace our third-party manufacturers immediately if one or more of them can no longer provide us with their manufacturing services. In addition, while we do not anticipate that we will encounter problems in obtaining adequate supplies of components, we cannot assure you that we will continue to be able to obtain components under

acceptable terms and in a timely manner.

## Sales and Marketing

Historically, we have primarily relied on third-party independent distributors to market and sell our products. Due to the lay-offs and scaled down efforts associated with the announced plan to sell substantially all assets of the Company, we expect sales and marketing activity to be minimal in the future.

## Customers

During the year ended December 31, 2010, we had four hospital customers that comprised 17.4%, 15.8%, 12.3%, and 10.5% of our net sales. During the year ended December 31, 2009, we had three hospital customers that comprised 28.1%, 22.7% and 13.2% of our net sales. The loss of any major hospital customer may have a material adverse effect on our business, financial condition and results of operations.

## Patents and Proprietary Technology; Trademarks

The patents and trademarks discussed below are part of the Reconstructive Division assets and Spine Division assets held for sale by us and they are not contemplated to be a part of our future business upon the successful sale of the Reconstructive Division assets and Spine Division assets.

## Patents

We have applied for U.S. and foreign patents covering several of our implant components, and some of our surgical instrumentation. As of December 31, 2010, we had 25 issued patents and 12 pending domestic and foreign patent applications covering seven devices.

Patents and intellectual property will continue to be an important aspect of the orthopedic and spine industry. In this regard, we intend to vigorously defend our intellectual property rights. We believe that our patents and products do not and will not infringe patents or violate proprietary rights of others, although it is possible that our existing patent rights may not be valid or that infringement of existing or future patents or proprietary rights may occur. If some of our intellectual property and agreements relating to our products are deemed invalid, that action may have a material adverse effect on our financial condition and results of operations.

The medical device industry is characterized by patent and other intellectual property litigation, and we could become subject to litigation that could be costly, result in diverting management's time and efforts, require us to pay damages and/or prevent us from marketing our existing or future products. Patent litigation typically involves complex factual and legal questions. The outcome of such litigation is uncertain. Any claim relating to infringement of patents that is successfully asserted against us may require us to pay substantial damages. Even if successful, litigation to enforce our intellectual property rights or to defend our patents against challenge could be expensive and time-consuming and could divert our management's attention. Our success will depend in part on our not infringing patents issued to others, including our competitors and potential competitors. If our products are found to infringe the patents of others, the development, manufacture and sale of our products or potential products could be severely restricted or prohibited. Also, our competitors may independently develop similar technologies that are not restricted by other companies' patents, including ours. Due to the importance of our patents to our business, our market share can decline if we fail to protect our intellectual property rights.

A patent infringement suit brought against us or our partners may force us or our partners to halt the development, manufacture or sale of products or potential products that are claimed to be infringing, unless that party grants us or our partners rights to use its intellectual property. As a result, we may be required to obtain licenses to patents or proprietary rights of others in order to continue to commercialize our products, which we may not be able to do on acceptable terms, or at all. Even if we or any partner were able to obtain rights to the third party's intellectual property, these rights may be non-exclusive, thereby giving our competitors access to the same intellectual property. Ultimately,

we may be unable to commercialize some of our products or potential products or may have to cease some of our business operations as a result of patent infringement claims, which could severely harm our business.

As more companies enter the orthopedic and spine market, the possibility of a patent infringement claim against us grows. While we try to ensure that our products do not infringe others' patents and proprietary rights, our products, potential products and methods may be covered by patents held by our competitors.

#### Trademarks

At December 31, 2010, we had four registered trademarks with the U.S. Patent and Trademark Office, or USPTO, for the marks "Accin", "Align 360", "Vertebrion" and "Cardo Medical"; and we have an application pending for the mark "A La Carte."

#### Competition

The orthopedic and spinal device industry is highly competitive and dominated by a number of large companies with substantially greater financial and other resources than we have. Our largest competitors in the orthopedic and spinal surgical device market are DePuy Orthopaedics, Inc. and DePuy Spine, Inc. (divisions of Johnson & Johnson Company), Zimmer, Inc. (a subsidiary of Zimmer Holdings, Inc.), Stryker Howmedica Osteonics (a subsidiary of Stryker Corporation), Smith & Nephew plc, Biomet Orthopedics, Inc. (a subsidiary of Biomet, Inc.), Medtronic Sofamor Danek, and Synthes Inc.

Companies in the industry compete on the basis of product features and design, innovation, service, the ability to maintain new product flow, relationships with key orthopedic surgeons and hospitals, the strength of their distribution network and price. While price is a key factor in the orthopedic market, other significant factors could negatively impact our results of operations and financial condition, including: technological innovation, reimbursement rates, surgeon preference, ease of use, clinical results and service provided by us and our representatives.

Our products are, and any potential products we commercialize will be, subject to intense competition. Many of our current and potential competitors have substantially greater financial, technical and marketing resources than we do, and they may succeed in developing products that would render our products obsolete or noncompetitive. Many of these competitors also have significantly greater operating history and reputations than we do in our respective fields. We may not be able to compete successfully if we are unable to develop proprietary products that reach the market in a timely manner, receive adequate reimbursement and are safer, less invasive and less expensive than alternatives available for the same purpose. Because of the rapidly growing orthopedic market, we anticipate that companies will dedicate significant resources to developing competing products.

Regarding our spinal portfolio, we also face competition from a growing number of smaller companies with more limited product offerings and geographic reach than our larger competitors. These companies, who represent intense competition in specified markets, include, Orthofix International N.V. (parent of Blackstone Medical, Inc.), Alphatec Spine Inc. (a subsidiary of Alphatec Holdings, Inc.), Wright Medical Group, Inc., and NuVasive, Inc.

#### Product Liability and Insurance

We are subject to potential product liability risks that are inherent in the design, marketing and sale of orthopedic implants and surgical instrumentation. We have implemented strict quality control measures and currently maintain product liability insurance in amounts that we believe are typical in the industry for companies with a comparable size to ours. Our insurance premiums are based on our sales. We evaluate our levels of product liability insurance annually, as well as the amount of retention carried compared to other comparable companies in the industry. Due to the volatility of the insurance marketplace, the value of the product liability insurance products delivered and the small number of providers of these products, there can be no guarantees as to whether we will be able to secure coverage in the future at a reasonable cost.



### Third-Party Reimbursement

Sales of our products will depend on the availability of adequate reimbursement from third-party payors (such as governmental programs, for example, Medicare and Medicaid, private insurance plans and managed care programs), both in terms of the sales volumes and prices of our products. Healthcare providers, such as hospitals that purchase medical devices for treating their patients, generally rely on third-party payors to reimburse all or part of the costs and fees associated with the procedures performed with these devices. These third-party payors may deny reimbursement if they feel that a device is not the most cost-effective treatment available, or was used for an unapproved indication. As such, surgeons are unlikely to use our products if they do not receive reimbursement adequate to cover the cost of their involvement in the surgical procedures. We also believe that future reimbursement may be subject to increased restrictions both in the U.S. and internationally. If we sell our products internationally, market acceptance may depend, in part, upon the availability of reimbursement within the prevailing healthcare payment systems. Reimbursement and healthcare payment systems in international markets vary significantly by country, and include both government sponsored healthcare and private insurance.

Future legislation, regulation or reimbursement policies of third-party payors may adversely affect the demand for our existing products or our products currently under development and limit our ability to sell our products on a profitable basis.

Also, third-party payors are increasingly challenging the prices charged for medical products and services. Particularly in the United States, third-party payors carefully review, and increasingly challenge, the prices charged for procedures and medical products. Also, greater numbers of insured individuals are receiving (and will continue to receive over the next decade) their medical care through managed care programs, which monitor and often require pre-approval of the services that a member will receive. Many managed care programs are paying their providers on a capitated basis, which puts the providers at financial risk for the services provided to their patients by paying them a predetermined payment per member per month.

Legislative or administrative reforms to the U.S. or international reimbursement systems in a manner that significantly reduces reimbursement for procedures using our medical devices or denies coverage for those procedures could have a material adverse effect on our business, financial condition or results of operations. We believe that the overall escalating cost of medical products and services has led to, and will continue to lead to, increased pressures on the healthcare industry to reduce the costs of products and services. We cannot assure you that third-party reimbursement and coverage will be available or adequate, or that future legislation, regulation, or reimbursement policies of third-party payors will not adversely affect the demand for our products or our ability to sell these products on a profitable basis. We also cannot assure you that our products will be considered cost-effective by third-party payors, that reimbursement will be available or, if available, that the third-party payors' reimbursement policies will not adversely affect our ability to sell our products profitably.

### Healthcare Fraud and Abuse

Our relationship with surgeons, hospitals and the marketers of our products are subject to scrutiny under various state and federal anti-kickback, self-referral, false claims and similar laws, often referred to collectively as healthcare fraud and abuse laws. The federal anti-kickback laws prohibit unlawful inducements for the referral of business reimbursable under federally-funded health care programs, such as remuneration provided to physicians to induce them to use certain medical devices reimbursable by Medicare or Medicaid. Healthcare fraud and abuse laws are complex and subject to evolving interpretations, and even minor, inadvertent violations potentially can give rise to claims that the relevant law has been violated. Certain states in which we market our products have similar anti-kickback, anti-fee splitting and self-referral laws, imposing substantial penalties for violations. Any violations of these laws could result in a material adverse effect on the market price of our common stock, as well as our business, financial condition and results of operations. We cannot assure you that any of the healthcare fraud and abuse laws will not change or be interpreted in the future in a manner which restricts or adversely affects our business activities or

relationships with surgeons, hospitals and marketers of our products. In addition, possible sanctions for violating these anti-kickback laws include monetary fines, civil and criminal penalties, exclusion from Medicare and Medicaid programs and forfeiture of amounts collected in violation of these prohibitions.

We must comply with a variety of other laws, such as laws prohibiting false claims for reimbursement under Medicare and Medicaid, which also can be triggered by violations of federal anti-kickback laws; Healthcare Insurance Portability and Accountability Act of 1996, which protects the privacy of individually identifiable healthcare information; and the Federal Trade Commission Act and similar laws regulating advertisement and consumer protections. In certain cases, federal and state authorities pursue actions for false claims on the basis that manufacturers and distributors are promoting unapproved or off-label uses of their products.

#### Employees

As of December 31, 2010, we employed 13 full-time employees.

#### Item 1A. Risk Factors

Our business, financial condition, results of operations, cash flows and prospects, and the prevailing market price and performance of our common stock, may be adversely affected by a number of factors, including the matters discussed below. Certain statements and information set forth in this Annual Report on Form 10-K, as well as other written or oral statements made from time to time by us or by our authorized officers on our behalf, constitute "forward-looking statements." You should note that our forward-looking statements speak only as of the date of this Annual Report on Form 10-K or when made and we undertake no duty or obligation to update or revise our forward-looking statements, whether as a result of new information, future events or otherwise. Although we believe that the expectations, plans, intentions and projections reflected in our forward-looking statements are reasonable, such statements are subject to known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements.

We have identified the following categories of risk that should be considered by investors:

- Risks related to the sale of substantially all of our assets
- Risks related to our business, industry and regulatory matters;
- Risks related to our financial results;
- Risks related to our intellectual property and potential litigation; and
- Risks related to ownership of our common stock.

Certain of the risks identified under "Risks Related to Our Business, Industry and Regulatory Matters," "Risks Related to Our Financial Results," and "Risks Related to Our Intellectual Property and Potential Litigation," describe factors that have historically posed risks to us and that could in the future adversely affect us if we do not successfully close on the sale of the Reconstructive Division assets and/or the Spine Division assets and we are able to continue operating our business, or if we acquire a business in the same or related industry in the future.

#### Risks Related to the Sale of Substantially all of our Assets

There can be no assurance that our pending sale of our Reconstructive Division assets will be consummated in a timely manner or at all. The failure of the asset sale to be consummated, could have an adverse effect on our business, financial condition, results of operations, prospects or stock price.

The pending sale of our Reconstructive Division assets is subject to a number of conditions to closing, including our receipt of all necessary consents, authorizations, orders and approvals from governmental authorities and that at least

twenty (20) calendar days have passed since we filed with the SEC and transmitted to the record holders of our shares a definitive information statement on Schedule 14C. If the closing conditions are not met or waived, we will be unable to consummate the asset sale. As a result, there can be no assurance that the asset sale will be completed in a timely manner or at all.

Further, the announcement and pendency of the asset sale could disrupt our business, in any of the following ways, among others:

- Our employees may experience uncertainty about their future roles, which might adversely affect our ability or Arthrex's ability to retain and/or hire key employees;
- The attention of our management may be directed toward the completion of the asset sale and transaction-related considerations and may be diverted from the day-to-day business operations; and
- Customers, suppliers or others may seek to modify or terminate their business relationships with us.

Additionally, due to our financial condition, we implemented certain cost-reduction measures commencing in the fall of 2010 such as terminating over half of our employees and deferring the manufacturing of inventories required to build additional base-level implant banks.

For the foregoing reasons, there can be no assurance that the announcement and pendency of the sale of our Reconstructive Division assets, or the failure of the asset sale to be consummated, will not have an adverse effect on our business, financial condition, results of operations, prospects or stock price.

If we fail to close the sale of the Reconstructive Division assets and we are unable to obtain adequate financing, we may be unable to repay and therefore trigger an event of default under the Arthrex Note.

Due to our current financial situation and the pending sale of the Reconstructive Division assets, we executed the Arthrex Note on March 18, 2011 in favor of Arthrex. Pursuant to the Arthrex Note, we promised to repay to Arthrex the principal amount outstanding from time to time on the Arthrex Note together with all accrued and unpaid interest on the maturity date. The maturity date of the note is the earlier of: (i) the closing of the transactions contemplated by the asset purchase agreement, (ii) the fifth day following the termination of the asset purchase agreement pursuant to its terms, and (iii) the end date (as defined in the asset purchase agreement). Pursuant to the Arthrex Note, we also granted, pledged and assigned to Arthrex a security interest in any and all assets (including, the acquired assets as defined in the asset purchase agreement), goods, inventories, properties and our business, either tangible, intangible, real, personal, mixed, together with all proceeds or products thereof including, without limitation, all leasehold interests, all payments under insurance, or any indemnity, warranty or guaranty, which security interest shall rank senior to and have priority over those held by all other creditors. If we fail to close the sale of the Reconstructive Division assets and we are unable to obtain alternative financing, we may be unable to repay the Arthrex Note and will therefore trigger an event of default enabling Arthrex to take all remedies available to it, including foreclosing on our assets and leaving us with no assets.

If we successfully complete the sale of the Reconstructive Division assets, we may face risks associated with enforcing Arthrex's obligation to make royalty payments under the asset purchase agreement or may receive royalty payments that are substantially less than our expectations.

As partial consideration for the Reconstructive Division asset sale under the terms of the asset purchase agreement, Arthrex shall pay us an amount equal to 5% of net sales of the products of our Reconstructive Division acquired pursuant to the asset purchase agreement. The royalty shall be paid in cash on a quarterly basis, for a period up to and including the 20th anniversary of the closing. We may experience difficulties collecting or enforcing the royalty payments over time, including if we fail to have the adequate resources to verify the underlying net sales. Additionally, we may ultimately collect royalty payments that are substantially less than our expectations if any of our intellectual property related to the Reconstructive Division assets becomes invalidated or rendered unenforceable due to Arthrex's right under the terms of the asset purchase agreement to set-off against the royalty payment due any and all out-of-pocket costs and expenses incurred in good faith arising out of claims by unaffiliated third parties alleging infringement of intellectual property rights.



If we successfully complete the sale of the Reconstructive Division assets, we have agreed to make certain changes to our remaining assets and operations which may adversely affect our reputation or future results or prospects.

Pursuant to the terms of the asset purchase agreement, we agreed that upon the closing of the sale of the Reconstructive Division assets, we will change our name, logos, trade dress, trade names, trademarks, service marks and the like to new names that are reasonably satisfactory to Arthrex and do not use the words "Cardo" or any variation thereof. Upon the closing of the sale of the Reconstructive Division assets, we intend to change our name to Tiger X Medical, Inc. Consequently, we will also change our trading symbol. These changes will eliminate any brand recognition, brand equity or loyalty we have developed over our operating history and may adversely affect our future reputation or future results or prospects.

If we successfully complete the sale of both the Reconstructive Division assets and the Spine Division assets, we will not have any operating businesses.

In October 2010, our management and Board of Directors decided to put substantially all of our assets up for sale. As discussed above, the sale of our Reconstructive Division assets is currently pending under a definitive agreement. Additionally, we intend to sell the Spine Division assets and have commenced negotiations for the sale of substantially all of the Spine Division assets. If we are successful in selling the Reconstructive Division assets and Spine Division assets, we will no longer have any operating business. Without any operating business or assets, we will not realize any revenues other than through the royalty payments we are entitled to under the terms of the Reconstructive Division asset sale and any future acquisition of an operating business or assets.

#### Risks Related to Our Business, Industry and Regulatory Matters

We may not be able to raise additional funds in the future, on acceptable terms or at all, to fund our operations and research.

We raised \$500,000 of additional funds during the fiscal year ended December 31, 2010 in contrast to \$9.0 million of additional funds we raised during the fiscal year ended December 31, 2009. Subsequent to December 31, 2010, we entered into the Arthrex Note and as of March 22, 2011, we have borrowed a total of \$972,000 under the Arthrex Note. Of the amount borrowed, \$522,000 was used to pay off the Brooks Note and Brien Note and \$450,000 was utilized to pay for vendors of inventory. If we fail to consummate the sale of the Reconstructive Division assets or the Spine Division Assets, we will not have sufficient funds to meet working capital requirements through 2011. Additionally, we cannot assure you that debt or equity financing, if and when required, will be available. Prior to agreeing to the sale of the Reconstructive Division assets, we were pursuing efforts to secure such funding but were not successful. The current market for debt and equity financing is challenging and the additional financing that we require may not be available at all or, if available, may be on terms unfavorable to us and our stockholders, and could substantially dilute current ownership interests. Further, if we raise additional funds through collaboration, licensing or other similar arrangements, it may be necessary to relinquish or share rights to our potential products or proprietary technologies, or to grant licenses on terms that are not favorable to us.

Our ability to continue as a going concern is dependent upon our closing the sale of the Reconstructive Division assets, finding a buyer for our Spine Division assets and consummating such sale or receiving additional funds either through the issuance of debt or through the sale of common and/or preferred stock and the success of management's implementation of a plan to address our future business and operations, if any.

Our actual capital requirements may change as a result of various factors, including:

- if we are able to successfully close on the sale of our Reconstructive Division assets and our Spine Division assets;

- results from preclinical studies and clinical trials conducted by us or our collaborative partners or licensees, if any;
- the nature and timing of acquisitions and other strategic transactions;
- our ability to maintain and establish corporate relationships and research collaborations;
- our ability to manage costs;

- the time and costs involved in filing, prosecuting, defending and enforcing patent and intellectual property claims;
- the cost and timing of obtaining and maintaining regulatory approval or clearance for our products and products in development;
- the expenses we incur in manufacturing and selling our products;
- the revenues generated by sales of our products; and
- the costs associated with our employee retention programs and related benefits.

If we are unable to successfully close the sale of the Reconstructive Division assets or the Spine Division assets, we will need to immediately raise funds or cease operations. Any of these events could have a material adverse effect on our business, financial condition and results of operations.

If we do not successfully close the sale of the Reconstructive Division assets or the Spine Division assets, we expect to incur significant losses, either directly or indirectly through the companies in which we develop our products, for at least the next fiscal year, and we cannot assure you that we will ever be profitable.

If we do not successfully close the sale of the Reconstructive Division assets or the Spine Division assets, we expect to incur significant losses during the next fiscal year, either directly or indirectly through the companies in which we develop our products, as we continue our operations. We cannot assure you that we will be successful in selling or licensing any of the products we might develop or predict the terms we may be able to obtain in any sales or licensing transaction.

We have a limited number of products currently available for sale and there is a high risk that our research and development efforts might not successfully generate any viable product candidates in the future.

We currently have nine products available for sale, all of which are in the early stages of distribution. Other than those nine products, we are in the preliminary stages of product identification and development, and have identified only a few potential additional products. We have not yet conducted preclinical studies or clinical testing on these potential additional products. It is unlikely that the few products that we have identified as potential candidates will actually lead to successful development efforts, and we do not expect any additional products resulting from our research to be commercially available for several years, if at all. Additionally, we determined to scale back our research and development activities in the fall of 2010. Our leads for potential products will be subject to the risks and failures inherent in developing medical devices and products, including, but not limited to, the unanticipated problems relating to research and development, product testing, confirming intellectual property rights and non-infringement, regulatory compliance, manufacturing, marketing and competition. Additional expenses may exceed current estimates and, therefore, adversely affect our profitability.

Healthcare policy changes, including recently enacted legislation reforming the U.S. healthcare system, may have a material adverse effect on our financial condition and results of operations.

Healthcare costs have risen significantly over the past decade, and there have been and continue to be proposals by legislators, regulators and third-party payors to keep these costs down. In 2010, Congress enacted significant health care reform legislation, specifically, the "Patient Protection and Affordable Care Act" and the "Health Care and Education Reconciliation Act," which legislation is now law. This legislation is considered by some to be the most dramatic change to the country's health care system in decades.

The principal aim of these laws is to expand health insurance coverage to approximately 32 million Americans who are currently uninsured. The law's most far-reaching changes do not take effect until 2014, including a requirement that most Americans carry health insurance. The consequences of these significant coverage expansions on the sales of the Company's products are unknown and speculative at this point.

These laws contain many provisions designed to generate the revenues necessary to fund the coverage expansions. The provisions which are most relevant to us are those that impose fees or taxes on certain health-related industries, including medical device manufacturers.

Beginning in 2013, each medical device manufacturer will have to pay an excise tax (or sales tax) in an amount equal to 2.3 percent of the price for which such manufacturer sells its medical devices. This tax applies to all medical devices, including the Company's products and product candidates. The effect, if any, of such tax on future sales is speculative.

In addition to the new laws discussed above, the effect of which cannot presently be quantified given its recent enactment, various healthcare reform proposals have also emerged at the state level. We cannot predict what healthcare initiatives, if any, will be implemented at the federal or state level, or the effect any future legislation or regulation will have on us. In addition to the taxes imposed by the new federal legislation, an expansion in government's role in the U.S. healthcare industry may lower reimbursements for our products, reduce medical procedure volumes and adversely affect our business, financial condition and results of operations, possibly materially.

Cost containment measures, pressure from our competitors and availability of medical reimbursement may impact our ability to sell our products at prices necessary to expand our operations and reach profitability.

Healthcare costs have risen significantly over the past decade and numerous initiatives and reforms initiated by legislators, regulators and third-party payors to curb these costs have resulted in a consolidation trend in the healthcare industry, including hospitals. This has resulted in greater pricing and other competitive pressures and the exclusion of certain suppliers from important market segments as group purchasing organizations, independent delivery networks and large single accounts continue to consolidate purchasing decisions for some hospital customers. We expect that market demand, government regulation, third-party reimbursement policies and societal pressures will continue to change the national and worldwide healthcare industry, resulting in further business consolidations and alliances among customers and competitors. This consolidation may reduce competition, exert downward pressure on the prices of our products and adversely impact our business, financial condition or results of operations.

Further, third-party payors in the United States and abroad continue to work to contain healthcare costs. The introduction of cost containment incentives, along with closer scrutiny of healthcare expenditures by both private health insurers and employers, has resulted in increased discounts and contractual adjustments to hospital charges for services performed and has shifted services between inpatient and outpatient settings. Hospitals or physicians may respond to these cost-containment pressures by substituting lower-cost products or other therapies for our products.

If we do not successfully close the sale of the Reconstructive Division assets or the Spine Division assets, we may continue to sell our products in the orthopedic industry. The market for orthopedic, knee and hip surgery devices is large and growing at a significant rate. Numerous new companies and technologies, as well as more established companies, have entered this market. New entrants to our markets include numerous niche companies with a singular product focus, as well as companies owned partially by surgeons, who may have greater access than we do to the surgeons who may use our products. As a result of this intensified competition, we believe there will be increasing pressure to reduce pricing of our medical devices. If we are unable to price our products appropriately due to these competitive pressures or for other reasons, our profit margins will shrink and our ability to invest in and grow our business and achieve profitability will decrease.

Sales of our products will depend on the availability of adequate reimbursement from third-party payors (such as governmental programs, for example, Medicare and Medicaid, private insurance plans and managed care programs), both in terms of the sales volumes and prices of our products.

Healthcare providers, such as hospitals that purchase medical devices for treating their patients, generally rely on third-party payors to reimburse all or part of the costs and fees associated with the procedures performed with these devices. These third-party payors may deny reimbursement if they feel that a device is not the most cost-effective treatment available, or was used for an unapproved indication. As such, surgeons are unlikely to use our products if they do not receive reimbursement adequate to cover the cost of their involvement in the surgical procedures. The

failure of surgeons to use our products, or the diminished use by surgeons, may have a material adverse impact on our business, financial condition and results of operations.

We also believe that future reimbursement from third-party payors may be subject to increased restrictions both in the U.S. and international markets. If we sell our products internationally, market acceptance may depend, in part, upon the availability of reimbursement within the prevailing healthcare payment systems. Reimbursement and healthcare payment systems in international markets vary significantly by country, and include both government sponsored healthcare and private insurance.

Future legislation, regulation or reimbursement policies of third-party payors may adversely affect the demand for our existing products or any of our products under development and limit our ability to sell our products on a profitable basis. Also, third-party payors are increasingly challenging the prices charged for medical products and services. Particularly in the United States, third-party payors carefully review, and increasingly challenge, the prices charged for procedures and medical products. Also, greater numbers of insured individuals are receiving (and will continue to receive over the next decade) their medical care through managed care programs, which monitor and often require pre-approval of the services that a member will receive. Many managed care programs are paying their providers on a capitated basis, which puts the providers at financial risk for the services provided to their patients by paying them a predetermined payment per member per month. Challenges by third-party payors to the prices charged for medical products and services, coupled with the increasing popularity of managed care programs, may result in hospitals and physicians seeking lower-cost alternatives to our products, the occurrence of which could materially adversely affect our business, financial condition and results of operations.

Healthcare providers, such as hospitals that purchase medical devices for treating their patients, generally rely on third-party payors to reimburse all or part of the costs and fees associated with the procedures performed with these devices. These third-party payors may deny reimbursement if they feel that a device is not the most cost-effective treatment available, or was used for an unapproved indication. As such, surgeons are unlikely to use our products if they do not receive reimbursement adequate to cover the cost of their involvement in the surgical procedures. We also believe that future reimbursement may be subject to increased restrictions both in the U.S. and international markets. If we sell our products internationally, market acceptance may depend, in part, upon the availability of reimbursement within the prevailing healthcare payment systems. Reimbursement and healthcare payment systems in international markets vary significantly by country, and include both government sponsored healthcare and private insurance.

Legislative or administrative reforms to the U.S. or international reimbursement systems in a manner that significantly reduces reimbursement for procedures using our medical devices or denies coverage for those procedures could have a material adverse effect on our business, financial condition or results of operations.

We believe that the overall escalating cost of medical products and services has led to, and will continue to lead to, increased pressures on the healthcare industry to reduce the costs of products and services. We cannot assure you that third-party reimbursement and coverage will be available or adequate, or that future legislation, regulation, or reimbursement policies of third-party payors will not adversely affect the demand for our products or our ability to sell these products on a profitable basis. We also cannot assure you that our products will be considered cost-effective by third-party payors, that reimbursement will be available or, if available, that the third-party payors' reimbursement policies will not adversely affect our ability to sell our products profitably.

We must convince orthopedic and spine surgeons that our products are an attractive alternative to existing surgical treatments of orthopedic and spine disorders.

If we do not successfully close the sale of the Reconstructive Division assets or the Spine Division assets we believe that in order to be commercially successful, we will need surgeons to adopt our products as their preferred treatment option for their patients. Surgeons may be slow to adopt our products for the following reasons, among others:

- lack of clinical evidence;
- the time that must be dedicated for training;

- lack of experience with our products;
- perceived risks generally associated with the use of new products and procedures;
- perceived risks associated with purchasing products from an early-stage medical device company;
- costs associated with the purchase of new products and equipment; and

- limited availability of reimbursement within healthcare payment systems.

We also believe that recommendations and support of our products by influential surgeons are essential for market acceptance and adoption. If we do not receive support from these surgeons, surgeons and hospitals may not use our products. As a result, we may not achieve expected revenues and may never become profitable.

Hospitals, surgeons, distributors and agents may have existing relationships with other medical device companies that make it difficult for us to establish new relationships with them. As a result, we may not be able to sell and market our products effectively.

If we do not successfully close the sale of the Reconstruction Division assets or the Spine Division assets, we believe that to sell and market our products effectively, we must establish relationships with key surgeons and hospitals in the field of orthopedic knee, hip and spinal surgery. Many of these key surgeons and hospitals already have long-standing relationships with large, better-known companies that dominate the medical devices industry through collaborative research programs and other relationships. Because of these existing relationships, some of which may be contractually enforced, surgeons and hospitals may be reluctant to adopt our products, particularly if our products compete with or have the potential to compete with products supported through their own collaborative research programs or by these existing relationships. Even if these surgeons and hospitals purchase our products, they may be unwilling to enter into collaborative relationships with us to promote joint marketing programs or to provide us with clinical and financial data.

We work primarily with a network of independent orthopedic product agents and distributors that generate sales leads for us. If these product agents and distributors believe that their relationship with us is less beneficial than other relationships they may have with more established or well-known medical device companies, they may be unwilling to continue their relationships with us, making it more difficult for us to sell and market our products effectively.

Our business plan relies on certain assumptions about the market for our products, which, if incorrect, may adversely affect our business and profitability.

We believe that the aging of the general population and increasingly active lifestyles will continue and that these trends will increase the need for our medical products. However, the projected demand for our products could differ materially from actual demand if our assumptions regarding these trends and acceptance of our products by the medical community prove to be incorrect or do not materialize, or if non-surgical treatments gain more widespread acceptance as a viable alternative to our devices.

We expect to face significant competition as a result of the rapid technological changes in the medical devices industry, which could have an adverse effect on our business, financial condition or results of operations.

The medical device market is highly competitive, subject to rapid change, and significantly affected by new product introductions and other market activities of industry participants. We expect to encounter intense competition across our product lines and in each market in which our products are sold from various medical device companies, many of which are likely to have greater financial and marketing resources than us. Currently, our primary competitors are Zimmer, J&J/DePuy Orthopaedics, Stryker and Biomet in the hips and knees market, and Medtronic/Sofamor Danek, J&J/DePuy Spine and Synthes in the spine market. In addition, we will face competition from a wide range of companies that sell a single or a limited number of competitive products or which participate only in a specific market segment, as well as from non-medical device companies, including pharmaceutical companies, which may offer alternative therapies for disease states intended to be treated using our products.

Additionally, the medical device market is characterized by extensive research and development, and rapid technological change. Developments by other companies of new or improved products, processes or technologies may make our products or proposed products obsolete or less competitive and may negatively impact our revenues. Since

we are unable to devote continued efforts and financial resources on research and development at this time due to our financial condition, we may have a limited ability or no ability to develop or acquire scientifically advanced technologies and products, apply our technologies cost-effectively across product lines and markets, attract and retain skilled development personnel, obtain patent and other protection for our technologies and products, obtain required regulatory and reimbursement approvals and successfully manufacture and market our

products consistent with our quality standards. If we fail to develop new products or enhance existing products, it could have a material adverse effect on our business, financial condition or results of operations.

Many of our larger competitors are either publicly traded or divisions or subsidiaries of publicly traded companies, and enjoy several competitive advantages over us, including:

- larger and more well-established distribution networks;
- established relationships with a greater number of surgeons, hospitals, other healthcare providers and third-party payors;
- products supported by long-term clinical data;
- greater experience in obtaining and maintaining regulatory approvals or clearances for products and product enhancements;
- greater name recognition;
- greater access to manufacturers, vendors and raw materials for manufacturing medical devices;
- more expansive portfolios of intellectual property rights; and
- greater financial and other resources for product research and development, sales and marketing, intellectual property protection and litigation.

We rely on single source manufacturers, which could impair our ability to meet demand for delivering our products in a timely manner or within our budget.

We rely on third-party manufacturers to manufacture our products. It is critical to our business that our contract manufacturers be able to provide us with products in substantial quantities, in accordance with agreed upon specifications, in compliance with regulatory requirements, at acceptable cost and on a timely basis. If we are unable to obtain sufficient quantities of high quality products to meet customer demand on a timely and cost-effective basis, we could lose customers, our reputation could be harmed and our business could suffer.

We currently use a variety of manufacturers for each of our devices. Our dependence on these manufacturers involves several risks, including limited control over pricing, availability, quality and delivery schedules. If any one or more of our manufacturers cease to provide us with sufficient quantities of our products in a timely manner or on terms acceptable to us, or cease to manufacture products of acceptable quality, we would have to seek alternative sources of manufacturing. We could experience delays while we locate and engage alternative qualified manufacturers, and we might be unable to engage alternative manufacturers on favorable terms, if at all. Any disruption or increased expenses relating to our supply source could harm our sales and marketing efforts and adversely affect our ability to generate revenue.

Loss of any major customer could have a material adverse effect on our business, financial condition and results of operations.

During the fiscal year ended December 31, 2010, four hospital customers accounted for approximately 55.9% of our net sales. The loss of any major customer could have a material adverse effect on our business, financial condition and results of operations. If we do not successfully close the sale of the Reconstructive Division assets or the Spine Division assets, we cannot guarantee that we will be able to retain long-term relationships with our major customers in the future.

We rely on our independent sales distributors and sales representatives to market and sell our products.

We depend upon independent sales distributors and sales representatives to market and sell our products, in particular due to their sales and service expertise and relationships with customers in the marketplace. Independent distributors and sales representatives may terminate their relationships with us or devote insufficient sales efforts to our products for any number of reasons. We do not control our independent distributors and they may not be successful in implementing our marketing plans. If we fail to maintain our existing relationships with our independent distributors and sales representatives, our operations would suffer. Similarly, our failure to recruit and retain additional skilled, independent sales distributors and sales representatives could have an adverse effect on our operations. We may experience turnover with some of our independent sales distributors, which could adversely affect our short-term

financial results while we transition to new distributors. Our failure to manage these transitions effectively could negatively impact our operations and profitability.

We are dependent on the services of Andrew A. Brooks, M.D. and Michael Kvitnitsky, and the loss of either of them could harm our business.

Our success depends in part upon the continued service of Andrew A. Brooks, M.D., who serves as our Chairman of the Board and Chief Executive Officer, and Michael Kvitnitsky, who serves as our President and Chief Operating Officer. Dr. Brooks and Mr. Kvitnitsky are critical to the overall management of our Company as well as to the preservation of our technology, our culture and our strategic direction. The loss of either Dr. Brooks or Mr. Kvitnitsky could have a material adverse effect on our business, results of operations and financial condition. We have not obtained and do not expect to obtain any key-person life insurance policies on Dr. Brooks or Mr. Kvitnitsky.

Failure to attract and retain skilled personnel and cultivate key academic collaborations, in the event that we do not successfully close the sale of the Reconstructive Division assets or the Spine Division assets, may adversely affect or delay product development and business development efforts.

The success of a company in our industry depends on its ability to continuously attract and retain highly qualified management and scientific personnel and its ability to develop relationships with academic collaborators. The competition for qualified personnel and collaborators is intense. Due to our current financial condition, we may not be able to attract or retain personnel or cultivate academic collaborations. In addition, our collaborators may have arrangements with other companies to assist those companies in developing products that compete with ours. Our inability to hire or retain qualified personnel or cultivate academic collaborations in the event that we do not successfully close the sale of the Reconstructive Division assets or the Spine Division assets and may adversely affect or delay product development and business development efforts.

If conflicts arise between collaborators or advisors and us, any of these parties may act in its self-interest, which may be adverse to our interests and the interests of our stockholders.

We have entered into arrangements with corporate collaborators and scientific advisors to help us develop and test potential products or enhance our existing products. If conflicts arise between us and any of these corporate collaborators or scientific advisors, the other party may act in its self-interest and not in our interest or the interests of our stockholders. It is possible that some of our corporate collaborators will be conducting multiple product development efforts within each area that is the subject of the collaboration with us. We also might be required to agree not to conduct independently, or with any third party, any research that is competitive with the research conducted under our collaborations. In addition, any of these collaborators may develop, either alone or with others, products in related fields that are competitive with the products or potential products that are the subject of our collaboration with them. Competing products, either developed by collaborators or to which collaborators have rights, may result in their withdrawing support for our product candidates.

If we fail to upgrade our management information systems, or if those systems do not operate as expected, we could experience significant disruption of our business and product developments and our results could suffer.

The efficient operation of our business is dependent on our management information systems, which we rely upon to effectively manage accounting and financial functions, manage order entry, order fulfillment and inventory replenishment processes, and maintain our research and development data.

Any failure of our management information systems to perform as we anticipate could disrupt our business and product development and could result in decreased sales, increased overhead costs, excess inventory and product shortages, causing our business and results of operations to suffer.

If a natural or man-made disaster strikes a facility in which our products are manufactured, we could be unable to deliver our products for a substantial amount of time and our sales could decline.

If a key third party facility is affected by a natural or man-made disaster, we would be forced to rely on another third-party manufacturer. We do not have insurance for potential losses as a result of damages to these manufacturing facilities.

If we decide to market and sell our devices and products internationally, we would be subject to various risks relating to our international activities, which could negatively impact our business and financial results.

We currently do not market or sell our products outside of the United States. However, we may actively pursue one or more international markets within the next few years, at which point we would be exposed to risks separate and distinct from those we face in our U.S. operations. Any international business we may engage in may be adversely affected by changing economic conditions in foreign countries, as well as U.S. laws that may affect the international business operations of a U.S. company such as ours. In addition, increases or decreases in the value of the U.S. dollar relative to foreign currencies could affect our results of operations since international sales most likely would be denominated in the functional currency of the country in which the product is sold.

Certain additional or different risks inherent in engaging in international business include the following:

- compliance with existing and changing foreign regulatory laws and requirements;
- export restrictions and controls and other government regulation relating to technology or medical devices;
- foreign laws and business practices favoring local companies;
- pricing pressures that we may experience internationally;
- the availability and level of reimbursement within prevailing foreign healthcare payment systems or insurance providers;
- shipping delays due to cross-border sales;
- longer payment cycles;
- difficulties and costs of establishing, staffing and managing foreign operations;
- potentially adverse tax consequences, tariffs and other trade barriers;
- difficulties in enforcing intellectual property rights;
- difficulties in enforcing agreements and collecting receivables through certain foreign legal systems;
- political and economic instability; and
- international terrorism and anti-American sentiment.

Our exposure to each of these risks may increase our costs, impair our ability to market and sell our products and require significant management attention, resulting in harm to our business and financial results.

We are subject to substantial governmental regulation that could change and thus force us to make modifications to how we develop, manufacture and price our products. Compliance with the various complex laws and regulations is costly and time consuming, and failure to comply can have adverse consequences on our business.

The medical device industry is regulated extensively by governmental authorities, principally the Food and Drug Administration, or the FDA, and corresponding state and foreign regulatory agencies. The FDA and other federal, state and foreign governmental agencies regulate, among other things, the development, manufacturing, clinical trials, marketing clearance and approval, promotion and sale of medical devices.

In particular, the FDA permits commercial distribution of a new medical device only after the device has received clearance under Section 510(k), or is the subject of an approved premarket approval application, or PMA. The FDA will approve marketing a medical device through the Section 510(k) process if it is demonstrated that the new product is substantially equivalent to other Section 510(k)-cleared products. The PMA process is more costly, lengthy and uncertain than the Section 510(k) clearance process. A PMA application must be supported by extensive data, including, but not limited to, technical, preclinical, clinical trial, manufacturing and labeling data, to demonstrate to the FDA's satisfaction the safety and efficacy of the device for its intended use. To date, all of our products, unless exempt, have been cleared through the Section 510(k) process. We have no experience in obtaining premarket approval.



Compliance with complex regulations is, and will continue to be, time-consuming, burdensome and expensive. Failure to comply with these regulations could jeopardize our ability to manufacture and sell our products and result in enforcement actions such as warning letters, fines, injunctions, civil penalties, termination of distribution, seizures of products, total or partial suspension of production, refusal of the FDA or other regulatory agencies to grant future clearances or approvals, or withdrawals or suspensions of current clearances or approvals. These enforcement actions could result in higher than anticipated costs or lower than anticipated revenue and have a material adverse effect on our business, financial condition and results of operations. In the most egregious cases, we could face criminal sanctions, closure of the manufacturing facilities in which our products are manufactured, and prohibitions on the sales of our products.

Foreign governmental authorities that regulate the manufacture and sale of medical devices have become increasingly vigilant, and if we engage in sales of our products in foreign countries, these sales would be subject to rigorous foreign regulations. In these circumstances, we would rely heavily on our foreign independent sales agencies to comply with the varying regulations, and any failures on their part could result in restrictions on the sale of our products in foreign countries. We currently do not sell any of our products internationally.

Federal regulatory reforms may adversely affect our ability to sell our products profitably.

Legislation may be drafted from time to time and introduced in Congress that could significantly change the statutory provisions governing the clearance or approval, manufacture and marketing of a medical device in the United States. In addition, FDA regulations and guidance often are revised or reinterpreted by the agency in ways that may significantly affect our business and our ability to commercialize our products. It is impossible to predict whether legislative changes will be enacted or FDA regulations, guidance or interpretations changed, and what the impact of these changes, if any, may be. For example, on September 27, 2007, Congress enacted, and the President signed into law, the Food and Drug Administration Amendments Act of 2007. This law grants significant new powers to the FDA and imposes new obligations and requirements on both the FDA and FDA-regulated industries, including the medical device industry. In particular, this law requires, among other things, that the FDA propose, and ultimately implement, regulations that will require manufacturers to label medical devices with unique identifiers unless a waiver is received from the FDA. In addition, it reauthorizes the FDA to collect medical device user fees and amends the existing user fee program by, among other things, reducing device application fees and imposing new fees, including a new annual establishment registration fee. Also, the new law authorizes the FDA to establish a unique medical device identification system and expands the federal government's clinical trial registry and results databank to include, among other things, information on medical device clinical trials. While these new requirements undoubtedly will have a significant effect on the medical device industry, we cannot yet predict the extent of that effect on our company. As regulations, guidance and interpretations are issued by the FDA relating to the new legislation, its impact on the industry, as well as our business, will become clearer. Compliance with those regulations could require us to take additional steps, and incur additional costs, in manufacturing and labeling products.

We have not yet collected long-term clinical data to support the safety of our products, and our products may, therefore, prove to be less safe and effective than initially thought.

We obtained clearance to offer all of our products that require FDA clearance or approval through the Section 510(k) clearance process, which is less rigorous than the PMA process and requires less supporting clinical data. As a result of using this expedited process, we currently lack the breadth of published long-term clinical data supporting the safety of our products and the benefits they offer that might have been generated using the PMA process. Because of the lack of this in-depth data, surgeons may be slow to adopt our products, we may not have comparative data that our competitors have or are generating, and we may be subject to greater regulatory and product liability risks. Further, future patient studies or clinical experience may indicate that treatment with our products does not improve outcomes. These results would reduce demand for our products, thereby preventing us from becoming profitable. If future results and experience indicate that our products cause unexpected or serious complications or other unforeseen negative effects, we could be subject to significant legal liability and harm to our business reputation. The medical device

market has been particularly prone to costly product liability litigation. The time and costs of any product liability litigation we may face may materially adversely affect our business, financial condition or results of operations, even if we are ultimately victorious in any such litigation.

The FDA requires us to obtain new Section 510(k) clearances or premarket approvals for modifications to our approved products. Otherwise, we may have to cease marketing, or to recall, the modified products until clearances are obtained.

Any modification to a Section 510(k)-cleared device that could significantly affect its safety or efficacy, or that would constitute a major change in its intended use, requires a new Section 510(k) clearance or, possibly, premarket approval. Under FDA regulations, every manufacturer must make this determination in the first instance, but the FDA may review any manufacturer's decision. The FDA may not agree with any of our decisions regarding whether new clearances or approvals are necessary. If the FDA requires us to seek Section 510(k) clearance or premarket approval for any modification to a previously cleared product, we may be required to cease marketing, or to recall, the modified product until we obtain clearance or approval. This may expose us to significant regulatory fines or penalties.

In addition, our products could be subject to recall if the FDA determines, for any reason, that our products are not safe or effective. Any recall or FDA requirement that we seek additional approvals or clearances could result in delays, fines, costs associated with modifying a product, loss of revenue, harm to our reputation and loss of customers and potential operating restrictions imposed by the FDA. Any product liability claim or recall would divert managerial and financial resources and could harm our reputation with customers. We cannot assure you that we will not have product liability claims or recalls in the future, or that these claims or recalls would not have a material adverse effect on our business.

If we or our third-party manufacturers fail to comply with the FDA's Quality System Regulations, the manufacture of our products could be interrupted and our product sales and operating results could suffer.

We and some of our third-party manufacturers are required to comply with the FDA's Quality System Regulation, or QSR, which covers the methods and documentation of the design, testing, production, control, quality assurance, labeling, packaging, sterilization, storage and shipping of our products. In addition, we and our manufacturers will be subject to the regulations of foreign jurisdictions regarding the manufacturing process if we market our products overseas.

The FDA enforces the QSR through periodic and unannounced inspections of manufacturing facilities. If our facilities or those of our manufacturers fail to take satisfactory corrective action in response to an adverse QSR inspection, the FDA could take enforcement action, including any of the following sanctions:

- customer notifications or repair, replacement, refunds, recall, detention or seizure of our products;
- operating restrictions or partial suspension or total shutdown of production;
- untitled letters, warning letters, fines, injunctions, consent decrees and civil penalties;
- refusing or delaying requests for Section 510(k) clearance or PMA approvals of new products or modified products;
- withdrawing Section 510(k) clearances or PMA approvals;
- refusal to grant export approval for our products; or
- criminal prosecution.

If we sell our products in the European Community, we will be required to maintain certain ISO certifications and must undergo periodic inspections by notified bodies to obtain and maintain these certifications. We cannot assure you that we or our manufacturers will be able to obtain or maintain all required registrations and certifications.

Any of these factors could impair our ability to produce our products in a cost-effective and timely manner in order to meet our customers' demands. We also may be required to bear other costs or take other actions that may have a negative impact on our future sales and our ability to generate profits.



Some proponents have advocated the creation of a national database or registry that tracks how patients with artificial joints fare. Any requirement for surgeons to participate in such a registry may adversely affect our ability to sell our products profitably.

Although the United States currently does not have a mandatory medical device registry, a few medical organizations in the country do, such as Kaiser Permanente and the Hospital for Specialty Surgery in New York, and some foreign countries do have national registries, such as Australia, Britain, Norway and Sweden. If a national or any state registry is created to collect data on how patients with artificial joints fare, surgeons who use our products would be required to provide information to that registry. Although it is difficult to determine all of the effects of the creation of a medical device registry, one effect it may have is to make surgeons use well-documented medical devices, instead of new ones. If the surgeons who use our products are required to participate in a national or state registry, they may be less inclined to use our products and, consequently, our ability to sell our products could be impaired.

#### Risks Related to Our Financial Results

We are an orthopedic medical device company with a limited operating history and our business may not become profitable.

We are an orthopedic medical device company with a limited operating history. We began commercial sales in 2007. We currently have the following nine products with Section 510(k) marketing clearance from the FDA: (1) Cardo Align 360™ Posterior-Stabilized Total Knee System; (2) Cardo Align 360™ Cruciate Retaining Knee System; (3) Cardo Align 360™ Unicompartamental Knee (used in partial knee replacement procedures); (4) Cardo Align 360™ Patello-Femoral Replacement (used in partial knee replacement procedures); (5) Cardo Total Hip System (used in total hip replacement procedures); (6) Cardo Bipolar Hip System (two-piece product used in femoral head replacement procedures); (7) Cardo Monopolar Hip System (one-piece product used in femoral head replacement procedures); (8) Cardo Cervical Plate (used in neck fusion procedures); and (9) Cardo Pedicle Screw System (used in lumbar spine fusion procedures).

If we do not successfully close the sale of the Reconstructive Division assets or the Spine Division assets, the success of our business will depend, in part, on our ability to develop and obtain regulatory clearances or approvals for enhancements to our products or for planned products, which we may be unable to do in a timely manner, or at all. Since we have a limited amount of working capital, our ability to develop enhancements to our products or develop new products will be limited. Additionally, our limited amount of working capital adversely impacts our ability to establish our sales and marketing force, generate product sales and control costs, and engage in research and development efforts to develop enhancements of these products or to develop new products.

We have a limited history of operations upon which you can evaluate our business, and our operating expenses are increasing. We have yet to demonstrate that we can generate ongoing sufficient sales of our products to become profitable. The extent of our future operating losses and the timing of profitability, if at all, are difficult to predict. Our lack of any significant operating history also limits your ability to make a comparative evaluation of us, our products and our prospects. Even if we do achieve profitability as planned, we may not be able to sustain or increase profitability on an ongoing basis.

Our quarterly financial results are likely to fluctuate significantly.

Our quarterly operating results have been difficult to predict and may fluctuate significantly from period to period, particularly because our sales prospects are uncertain and sales are difficult to forecast. These fluctuations also may affect our annual operating results and may cause those results to fluctuate unexpectedly from year to year. Historically, the level of our revenues and results of operations at any given time have been based primarily on the following factors:

- our ability to increase sales of our products;
- results of clinical research and trials on our current or planned products;
- our ability to obtain regulatory approvals;
- legislative and reimbursement policy changes affecting the products we may offer or those of our competitors;

- the variability of the profit margins among the products we sell;
- our ability to maintain an effective and dedicated sales force;
- pricing pressure from competitors applicable to our products;
- adverse third-party reimbursement outcomes;
- timing of new product launches, acquisitions, licenses or other significant events by us or our competitors;
- the ability of our manufacturers to timely provide us with an adequate supply of products and meet our quality requirements; and
- interruption in the manufacturing or distribution of our products.

Upon the closing of the sale of the Reconstructive Division assets, our revenues will primarily consist of royalty payments by Arthrex. Under the terms of the asset purchase agreement, Arthrex shall pay us an amount equal to 5% of net sales of the products of our Reconstructive Division acquired pursuant to the asset purchase agreement. The royalty shall be paid in cash on a quarterly basis, for a period up to and including the 20th anniversary of the closing. As a result our quarterly operating results will be difficult to predict and may fluctuate significantly from period to period, particularly because net sales of the products of our Reconstructive Division acquired pursuant to the asset purchase agreement may be difficult to forecast. Additionally, we may experience difficulties collecting or enforcing the royalty payments over time, including if we fail to have the adequate resources to verify the underlying net sales, which may also adversely affect our quarterly financial results. We may also ultimately collect royalty payments that are substantially less than our expectations if any of our intellectual property related to the Reconstructive Division assets becomes invalidated or rendered unenforceable due to Arthrex's right under the terms of the asset purchase agreement to set-off against the royalty payment due any and all out-of-pocket costs and expenses incurred in good faith arising out of claims by unaffiliated third parties alleging infringement of intellectual property rights. These factors may further exacerbate the predictability of our quarterly operating results and the potential for significant fluctuations from period to period.

For all the foregoing reasons, it will be difficult for us to forecast quarterly results with any degree of certainty. Accordingly, we may experience significant, unanticipated quarterly losses. Because of these factors, our operating results in one or more future quarters may fail to meet the expectations of securities analysts or investors.

#### Risks Related to Our Intellectual Property and Potential Litigation

If we cannot adequately protect our patents and other intellectual property rights, we may lose market share to our competitors and be unable to operate our business profitably.

Our success depends on our ability to protect our proprietary rights to the technologies used in our products. We rely significantly on patent protection, as well as a combination of trade secrets, know-how, continuing technological innovations, strategic alliances and licensing opportunities to develop, maintain and strengthen our competitive position. We also expect to pursue a policy of generally obtaining patent protection in both the United States and abroad for patentable subject matter in our proprietary devices and attempt to review third-party patents and patent applications to the extent they become known to develop an effective patent strategy, avoid infringing third-party patents, identify licensing opportunities and monitor the patent claims of others.

We have a number of U.S. and foreign patent applications pending in spine, hip and knee reconstructive surgery. Although we have filed these patent applications, we cannot assure you that any patents may issue or that, if they issue, these patents will adequately protect our rights or permit us to gain or keep any competitive advantage.

The U.S. Patent and Trademark Office, or USPTO, may deny or require significant narrowing of claims in our pending patent applications, and patents issued as a result of the pending patent applications, if any, may not provide us with significant commercial protection or be issued in a form that is advantageous to us. We also could incur substantial costs in proceedings before the USPTO. These proceedings could result in adverse decisions as to the priority of our inventions and the narrowing or invalidation of claims in any patents that may issue. Any U.S. and

foreign patents that may be issued in the future could subsequently be successfully challenged by others and invalidated or rendered unenforceable, which could limit our ability to stop competitors from marketing and selling related products. Additionally, if we successfully close the sale of the Reconstructive Division assets, we may ultimately collect royalty payments that are substantially less than our expectations if any of our underlying intellectual property related to the Reconstructive Division assets becomes invalidated or rendered unenforceable.

Both the patent application process and the process of managing patent disputes can be time-consuming and expensive. Competitors may be able to design around our patents or develop products that provide outcomes that are comparable to our products. Although we have entered into confidentiality agreements and intellectual property assignment agreements with certain of our employees, consultants and advisors as one of the ways we seek to protect our intellectual property and other proprietary technology, these agreements may not be enforceable or may not provide meaningful protection for our trade secrets or other proprietary information in the event of unauthorized use or disclosure or other breaches of the agreements. Furthermore, the laws of some foreign countries may not protect our intellectual property rights to the same extent as the laws of the United States, if at all. Since most of our pending patent applications are for the United States only, we lack a corresponding scope of patent protection in other countries. Thus, we may not be able to stop a competitor from marketing products in other countries that are similar to some of our products.

Changes to intellectual property laws may negatively impact our ability to protect our intellectual property.

Congress is considering several significant changes to the U.S. patent laws, including changing from a "first to invent" to a "first inventor to file" system, requiring that patent lawsuits be brought in the forum of the defendant, requiring the apportionment of patent damages, and creating a post-grant opposition process to challenge patents after they have issued. Further, changes to a foreign country's intellectual property laws can occur and result in a negative effect on our current rights or our ability to obtain or enforce rights in the future.

The medical device industry is characterized by patent and other intellectual property litigation, and we could become subject to litigation that could be costly, result in diverting management's time and efforts, require us to pay damages, and/or prevent us from marketing our existing or future products.

The medical device market in which we primarily participate is in large part technology-driven. Physician customers move quickly to new products and new technologies. As a result, intellectual property rights, particularly patents and trade secrets, play a significant role in product development and differentiation. However, intellectual property litigation to defend or create market advantage is inherently complex, unpredictable, time-consuming and costly. Furthermore, appellate courts frequently overturn lower court patent decisions.

In addition, competing parties frequently file multiple suits to leverage patent portfolios across product lines, technologies and geographies and to balance risk and exposure between the parties. In some cases, several competitors are parties in the same proceeding, or in a series of related proceedings, or litigate multiple features of a single class of medical devices. These forces frequently drive settlement not only of individual cases, but also of a series of pending and potentially related and unrelated cases. In addition, although monetary and injunctive relief is typically sought, remedies and restitution generally are not determined until the conclusion of the proceedings and are frequently modified on appeal. Accordingly, the outcomes of individual cases are difficult to time, predict or quantify and are often dependent upon the outcomes of other cases in other geographies.

Certain product categories, including pedicle screws, have been subject to significant patent litigation in recent years. Since we sell orthopedic and spinal devices, such as pedicle screws, knee replacement devices, and cervical plates, and we recently introduced our pedicle screw system, any related litigation could harm our business.

We also may have to take legal action in the future to protect our patents, trade secrets or know-how or to assert them against claimed infringement by others. Any legal action of that type could be costly and time-consuming, and we cannot assure you that any lawsuit will be successful. In addition, we may not have sufficient resources to enforce our intellectual property rights or to defend our patents against a challenge.

Further, we intend to protect our proprietary technology, in part, through proprietary information and inventions agreements with employees, consultants and other parties. These agreements with some of our employees and consultants generally contain standard provisions requiring those individuals to assign to the employer, without

additional consideration, inventions conceived or reduced to practice by them while employed or retained by the employer, subject to customary exceptions. If any of our employees, consultants or others breach these agreements, or if these agreements are found to be unenforceable, competitors may learn of our trade secrets and proprietary information.

For the reasons indicated above, enforcing our intellectual property rights may be costly, difficult and time-consuming. Even if successful, litigation to enforce our intellectual property rights or to defend our patents against challenge could be expensive and time-consuming and could divert our management's attention.

Patent infringement lawsuits brought against us could have a material adverse affect on our ability to develop and sell our products and to operate profitably.

As the number of entrants into our market increases, the possibility of a patent infringement claim against us grows. While we make an effort to ensure that our products do not infringe other parties' patents and proprietary rights, our products and methods may be covered by patents held by our competitors. In addition, our competitors may assert that future products we may market infringe their patents.

A patent infringement suit brought against us or any strategic partners or licensees may force us or any strategic partners or licensees to stop or delay developing, using, manufacturing, importing or selling potential products that are claimed to infringe a third party's intellectual property, unless that party grants us or any strategic partners or licensees rights to use its intellectual property. In those cases, we may be required to obtain licenses to patents or proprietary rights of others in order to continue to commercialize our products. However, we may not be able to obtain any licenses required under any patents or proprietary rights of third parties on acceptable terms, or at all, and any licenses may require substantial royalties or other payments by us. Even if we, any strategic partners or licensees were able to obtain rights to the third party's intellectual property, these rights may be non-exclusive, thereby giving our competitors access to the same intellectual property. Ultimately, we may be unable to commercialize some of our potential products or may have to cease some of our business operations as a result of patent infringement claims, which could severely harm our business.

We may be subject to damages resulting from claims that we or our employees or consultants have wrongfully used or disclosed alleged trade secrets of their former employers.

Some of our employees and consultants were previously employed or engaged at universities or other medical device companies, including our competitors or potential competitors. We could in the future be subject to claims that these employees and consultants, or we, have inadvertently or otherwise used or disclosed trade secrets or other proprietary information of their former employers. Litigation may be necessary to defend against these claims. If we fail to defend against these claims, a court could order us to pay substantial damages and prohibit us from using technologies or features that are essential to our products and processes, if these technologies or features are found to incorporate or be derived from the trade secrets or other proprietary information of the former employers. In addition, we may lose valuable intellectual property rights or personnel. A loss of key research personnel or their work product could hamper or prevent our ability to commercialize certain potential products, which could severely harm our business. Even if we are successful in defending against these claims, litigation could result in substantial costs and be a distraction to management.

Some countries may require us to grant compulsory licenses to third parties. These licenses could be extended to include some of our products or potential product, which may limit our potential revenue opportunities.

Many jurisdictions, including certain countries in Europe, have compulsory licensing laws under which a patent owner may be compelled to grant licenses to third parties. In addition, most countries limit the enforceability of patents against government agencies or government contractors. In these countries, the patent owner may be limited to monetary relief and may be unable to enjoin infringement, which could materially diminish the value of the patent. Compulsory licensing of life-saving products also is becoming increasingly popular in developing countries, either through direct legislation or international initiatives. These compulsory licenses could be extended to include some of our products or product candidates, which may limit our potential revenue opportunities.

Fluctuations in the cost and availability of insurance could adversely affect our profitability or our risk management profile.

We hold a number of insurance policies, including product liability insurance, errors and omissions insurance, directors' and officers' liability insurance, property insurance, general liability insurance, employee benefits liability and workers' compensation insurance. If the costs of maintaining adequate insurance coverage increases significantly at any time, our operating results could be materially adversely impacted. Likewise, if any of our

current insurance coverage should become unavailable to us or become economically impractical, we would be required to operate our business without indemnity from commercial insurance providers.

Potential future product liability claims and other litigation, including contract litigation, may adversely affect our business, reputation and ability to attract and retain customers.

Reconstructive and spine surgery involves a high risk of serious complications, including bleeding, nerve injury, paralysis and even death. As a result, we are exposed to potential product liability claims that are inherent in the testing, manufacture and sale of medical devices for surgery procedures. Many of these medical devices are designed to be implanted in the human body for long periods of time or indefinitely. A number of factors could result in an unsafe condition or injury to, or death of, a patient with respect to these or other products that we manufacture or sell, including component failures, manufacturing flaws, design defects or inadequate disclosure of product-related risks or product-related information. These factors could result in product liability claims, a recall of one or more products or a safety alert relating to one or more products. Product liability claims may be brought by individuals or by groups seeking to represent a class.

In connection with our acquisition of the assets of Accin Corporation, which we refer to as Accin, in May 2007 (through our ownership of Accelerated Innovation, which we refer to as Accelerated Innovation, one of our former subsidiaries) and as a result of the reverse merger we completed in August 2008, which we refer to as the Merger, we assumed the responsibility for any litigation or claims related to Accin's business, including product liability claims relating to products previously sold by Accin. The outcome of litigation, particularly class action lawsuits, is difficult to assess or quantify. Plaintiffs in these lawsuits often seek recovery of very large or indeterminate amounts, including not only actual damages, but also punitive damages. The magnitude of the potential loss relating to these lawsuits may remain unknown for substantial periods of time. In addition, the cost to defend against any future litigation may be significant.

Any product liability claim brought against us, with or without merit, could result in the increase of our insurance rates or the inability to secure coverage in the future. In addition, if our product liability insurance proves to be inadequate to pay a damage award, we may have to pay the excess out of our cash reserves, which may harm our financial condition. If longer-term patient results and experience indicate that our products or any component cause tissue damage, motor impairment or other adverse effects, we could be subject to significant liability. Finally, even a meritless or unsuccessful product liability claim could harm our reputation in the industry, lead to significant legal fees and result in diverting management's attention from managing our business.

Even if any product liability loss is covered by an insurance policy, these policies have substantial retentions or deductibles that provide that insurance proceeds are not recoverable until the losses incurred exceed the amount of those retentions or deductibles. To the extent that any losses are below these retentions or deductibles, we will be responsible for paying these losses. Paying retentions or deductibles for a significant amount of claims could have a material adverse effect on our business, financial condition and results of operations.

Further, it is possible that we may in the future be substantially self-insured with respect to general and product liability claims. As a result of economic factors currently impacting the insurance industry, meaningful product liability insurance coverage also may become unavailable due to its economically prohibitive cost. The absence of significant third-party insurance coverage increases potential exposure to unanticipated claims and adverse decisions. As a result, product liability claims, product recalls and other litigation in the future, regardless of their outcome, could have a material adverse effect on our financial position, results of operations or liquidity.

Any claims relating to our making improper payments to physicians for consulting services, or other potential violations of regulations governing interactions between us and healthcare providers, could be time-consuming and costly.

Our relationship with surgeons, hospitals and the marketers of our products are subject to scrutiny under various state and federal anti-kickback, self-referral, false claims and similar laws, often referred to collectively as healthcare fraud and abuse laws. The federal anti-kickback laws prohibit unlawful inducements for the referral of business reimbursable under federally-funded health care programs, such as remuneration provided to physicians to induce them to use certain medical devices reimbursable by Medicare or Medicaid. Healthcare fraud and abuse laws are complex and subject to evolving interpretations, and even minor, inadvertent violations potentially can give rise

to claims that the relevant law has been violated. Certain states in which we market our products have similar anti-kickback, anti-fee splitting and self-referral laws, imposing substantial penalties for violations. Any violations of these laws could result in a material adverse effect on the market price of our common stock, as well as our business, financial condition and results of operations. We cannot assure you that any of the healthcare fraud and abuse laws will not change or be interpreted in the future in a manner which restricts or adversely affects our business activities or relationships with surgeons, hospitals and marketers of our products. In addition, possible sanctions for violating these anti-kickback laws include monetary fines, civil and criminal penalties, exclusion from Medicare and Medicaid programs and forfeiture of amounts collected in violation of these prohibitions.

Federal anti-kickback laws and regulations prohibit any knowing and willful offer, payment, solicitation or receipt of any form of remuneration by an individual or entity in return for, or to induce:

- the referral of an individual for a service or product for which payment may be made by Medicare, Medicaid or other government-sponsored healthcare program; or
- purchasing, leasing, ordering or arranging for any service or product for which payment may be made by a government-sponsored healthcare program.

We must comply with a variety of other laws, such as laws prohibiting false claims for reimbursement under Medicare and Medicaid, which also can be triggered by violations of federal anti-kickback laws; Healthcare Insurance Portability and Accountability Act of 1996, which protects the privacy of individually identifiable healthcare information; and the Federal Trade Commission Act and similar laws regulating advertisement and consumer protections. In certain cases, federal and state authorities pursue actions for false claims on the basis that manufacturers and distributors are promoting unapproved or off-label uses of their products.

Pursuant to FDA regulations, we can market our products only for cleared or approved uses. Although surgeons are permitted to use medical devices for indications other than those cleared or approved by the FDA based on their medical judgment, we are prohibited from promoting products for those off-label uses. We market our products and provide promotional materials and training programs to surgeons regarding the use of our products. Although we believe our marketing, promotional materials and training programs for surgeons do not constitute promotion of unapproved uses of our products, if it is determined that our marketing, promotional materials or training programs constitute promotion of unapproved uses, we could be subject to significant fines in addition to regulatory enforcement actions, including the issuance of a warning letter, injunction, seizure and criminal penalty.

The scope and enforcement of these laws is uncertain and subject to rapid change, especially in light of the lack of applicable precedent and regulations. We cannot assure you that federal or state regulatory authorities will not challenge or investigate our current or future activities under these laws. Any challenge or investigation could have a material adverse effect on our business, financial condition and results of operations. Any state or federal regulatory review of us, regardless of the outcome, would be costly and time-consuming. Additionally, we cannot predict the impact of any changes in these laws, and whether or not they will be retroactive.

#### Risks Related to Ownership of Our Common Stock

Our common stock may be thinly traded.

There is a very minimal public market for our common stock. We cannot predict how liquid the market for our common stock might become. Our common stock will likely be thinly traded compared to larger more widely known companies.

Trades of our common stock are conducted on the OTC Bulletin Board. If our common stock remains listed on the OTC Bulletin Board or is suspended from the OTC Bulletin Board, the trading price of our common stock could suffer, the trading market for our common stock may be less liquid and our common stock price may be subject to

increased volatility.

Furthermore, for companies whose securities are traded in the OTC Bulletin Board, it is more difficult to obtain accurate stock quotations and raise needed capital. Also, because major wire services generally do not publish press releases about these companies, it is also more difficult for them to obtain coverage for significant news and events.

In addition, the price at which our common stock may be sold is very unpredictable because there could be very few trades in our common stock. We cannot predict the extent to which an active public market for our common stock will develop or be sustained at any time in the future. If our common stock is thinly traded, a large block of shares traded can lead to a dramatic fluctuation in the share price.

We expect that the price of our common stock will fluctuate substantially, potentially adversely affecting the ability of investors to sell their shares.

The market price of our common stock is likely to be highly volatile and subject to wide fluctuations in response to the following factors, many of which are generally beyond our control. These factors may include:

- the successful consummation of the sale of the Reconstructive Division assets and or Spine Division assets on our expected timeline, or at all;
- volume and timing of orders for our products;
- the introduction of new products or product enhancements by us or our competitors;
- quarterly variations in our or our competitor's results of operations;
- announcements of technological or medical innovations for treating spine, knee and hip pathologies;
- our ability to develop, obtain regulatory clearance or approval for, and market new and enhanced products on a timely basis;
- changes in governmental regulations or in the status of our regulatory approvals, clearances or applications, including announcements of actions by the FDA or other regulatory agencies;
- changes in the availability of third-party reimbursement in the United States or other countries;
- the acquisition or divestiture of businesses, products, assets or technology;
- disputes, litigation or other developments with respect to intellectual property rights or other potential legal actions;
- changes in earnings estimates or recommendations by securities analysts; and
- general market conditions and other factors, including factors unrelated to our operating performance or the operating performance of our competitors.

Market price fluctuations may negatively affect the ability of investors to sell our shares at consistent prices.

We may become involved in securities class action litigation that could divert management's attention and harm its business.

The stock market in general and the stocks of medical device companies in particular have experienced extreme price and volume fluctuations. These fluctuations have often been unrelated or disproportionate to the operating performance of the companies involved. If these fluctuations occur in the future, the market price of our shares could fall regardless of our operating performance. In the past, following periods of volatility in the market price of a particular company's securities, securities class action litigation has been brought against that company. If the market price or volume of our shares suffers extreme fluctuations, then we may become involved in this type of litigation which would be expensive and divert management's attention and resources from managing the business.

Securities analysts may elect not to report on our common stock or may issue negative reports that adversely affect the price of our common stock.

At this time, no securities analyst provides research coverage of our common stock. Further, securities analysts may never provide this coverage in the future. Rules mandated by the Sarbanes Oxley Act of 2002 and other restrictions led to a number of fundamental changes in how analysts are reviewed and compensated. In particular, many investment banking firms are required to contract with independent financial analysts for their stock research. It may remain difficult for a company with a smaller market capitalization such as ours to attract independent financial analysts that will cover our common stock. If securities analysts do not cover our common stock, the lack of research

coverage may adversely affect our actual and potential market price and trading volume.

The trading market for our common stock may be affected in part by the research and reports that industry or financial analysts publish about our business. If one or more analysts elect to cover our company and then downgrade the stock, the stock price would likely decline rapidly. If one or more of these analysts cease coverage of our company, we could lose visibility in the market, which in turn could cause our stock price to decline. This could have a negative effect on the market price of our shares.

Anti-takeover provisions in our charter documents and Delaware law may discourage or prevent a change in control, even if an acquisition would be beneficial to our stockholders, which could affect our stock price adversely and prevent attempts by our stockholders to replace or remove our current management.

Our Certificate of Incorporation and Bylaws contain provisions that could delay or prevent a change in control of our company or changes in our Board of Directors that our stockholders might consider favorable. Some of these provisions:

- impose limitations on our stockholders to call special stockholder meetings; and
- authorize the issuance of preferred stock which can be created and issued by the Board of Directors without prior stockholder approval, with rights senior to those of the common stock.

In addition, we are subject to the provisions of Section 203 of the Delaware General Corporation Law, which may prohibit certain business combinations with stockholders owning 15% or more of our outstanding voting stock. These and other provisions in our Certificate of Incorporation, our Bylaws and Delaware law could make it more difficult for stockholders or potential acquirers to obtain control of our Board of Directors or initiate actions that are opposed by our then-current Board of Directors, including to delay or impede a merger, tender offer or proxy contest involving our company. Any delay or prevention of a change in control transaction or changes in our Board of Directors could cause the market price of our common stock to decline.

Because our common stock may be a "penny stock," it may be more difficult for investors to sell shares of our common stock, and the market price of our common stock may be adversely affected.

Our common stock may be a "penny stock" if, among other things, the stock price is below \$5.00 per share, we are not listed for trading on a national securities exchange or approved for quotation on the Nasdaq Stock Market or any other national stock exchange, or we have not met certain net tangible asset or average revenue requirements. Broker-dealers who sell penny stocks must provide purchasers of these stocks with a standardized risk-disclosure document prepared by the SEC. This document provides information about penny stocks and the nature and level of risks involved in investing in the penny-stock market. A broker also must give a purchaser, orally or in writing, bid and offer quotations and information regarding broker and salesperson compensation, make a written determination that the penny stock is a suitable investment for the purchaser, and obtain the purchaser's written agreement to the purchase. In addition, broker-dealers must provide customers that hold penny stock in their accounts with that broker-dealer a monthly statement containing price and market information relating to the penny stock. If a penny stock is sold to an investor in violation of the penny stock rules, the investor may be able to cancel its purchase and get its money back.

If applicable, the penny stock rules may make it difficult for investors to sell their shares of our common stock. Because of the rules and restrictions applicable to a penny stock, there is less trading in penny stocks and the market price of our common stock may be adversely affected. Also, many brokers choose not to participate in penny stock transactions. Accordingly, investors may not always be able to resell their shares of our common stock publicly at times and prices that they feel are appropriate.

Directors, executive officers, principal stockholders and affiliated entities own a significant percentage of our capital stock, and they may make decisions that you do not consider to be in the best interests of our stockholders.

As of December 31, 2010, our directors, executive officers, principal stockholders and affiliated entities beneficially owned, in the aggregate, approximately 59% of our outstanding voting securities. As a result, if some or all of them acted together, they would have the ability to exert substantial influence over the election of our Board of Directors and the outcome of issues requiring approval by our stockholders. This concentration of ownership also may have the effect of delaying or preventing a change in control of our Company that may be favored by other stockholders.

This could prevent transactions in which stockholders might otherwise recover a premium for their shares over current market prices.

Our stock price could decline as a result of our failure to meet reporting and other regulatory requirements.

Our management team is responsible for our operations, reporting and compliance. Our failure to comply with the Sarbanes-Oxley Act, once our Company becomes subject thereto, and/or the reporting requirements and other provisions of securities laws could negatively affect our stock price and adversely affect our results of operations, cash flow and financial condition.

Operating as a small public company also requires us to make forward-looking statements about future operating results and to provide some guidance to the public markets. Our management team has limited experience serving in a managerial capacity in a public company and as a result projections may not be made timely or set at expected performance levels and could materially affect the price of our shares. Any failure to meet published forward-looking statements that adversely affect the stock price could result in losses to investors, stockholder lawsuits or other litigation, sanctions or restrictions issued by the SEC or any stock market upon which our stock is traded.

Failure to maintain effective internal controls in accordance with Section 404 of the Sarbanes- Oxley Act could have a material adverse effect on our business and stock price.

Section 404 of the Sarbanes-Oxley Act of 2002, which we refer to as Section 404, requires management's annual review and evaluation of our internal control systems. We have expended and expect to continue to expend significant resources and management time documenting and testing our internal control systems and procedures. If we fail to maintain the adequacy of our internal control over financial reporting, as such standards are modified, supplemented or amended from time to time, we may not be able to ensure that we can conclude on an ongoing basis that we have effective internal control over financial reporting in accordance with Section 404. Absolute assurance also cannot be provided that testing will reveal all material weaknesses or significant deficiencies in internal control over financial reporting.

Privately-held businesses are not subject to the same requirements for internal controls as public companies. While we intend to address any material weaknesses at acquired companies, there is no assurance that this will be accomplished. If we fail to strengthen the effectiveness of acquired companies' internal controls, we may not be able to conclude on an ongoing basis that we have effective internal control over financial reporting in accordance with Section 404. Failure to achieve and maintain an effective internal control environment could have a material adverse effect on our business and stock price.

Our status as a public company may make it more difficult to attract and retain officers and directors.

The Sarbanes-Oxley Act and new rules subsequently implemented by the SEC have required changes in corporate governance practices of public companies. If we successfully close the sale of the Reconstructive Division assets and or the Spine Division assets, we intend to remain a public company and therefore expect the continued adherence to these rules and regulations will continue to result in significant compliance costs in 2011 and beyond and to make certain activities more time-consuming and costly than if we were not a public company. As a public company, we also expect that these rules and regulations may make it more difficult and expensive for us to obtain director and officer liability insurance in the future, and we may be required to accept reduced policy limits and coverage or incur substantially higher costs to obtain the same or similar coverage. As a result, it may be more difficult for us to attract and retain qualified persons to serve on our Board of Directors or as executive officers.

Compliance with changing regulations concerning corporate governance and public disclosure may result in additional expenses.

There have been changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act, new regulations promulgated by the SEC and rules promulgated by the NYSE AMEX LLC and other national securities exchanges. These new or changed laws, regulations and standards are subject to varying interpretations in many cases due to their lack of specificity, and, as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies, which could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to

disclosure and governance practices. As a result, our efforts to comply with evolving laws, regulations and standards are likely to continue to result in increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities. Our board members, Chief Executive Officer and Chief Financial Officer could face an increased risk of personal liability in connection with the performance of their duties. As a result, we may have difficulty attracting and retaining qualified board members and executive officers, which could harm our business. If our efforts to comply with new or changed laws, regulations and standards differ from the activities intended by regulatory or governing bodies, we could be subject to liability under applicable laws or our reputation may be harmed.

Stockholders may experience significant dilution if future equity offerings are used to fund operations or acquire complementary businesses.

If future operations or acquisitions are financed through issuing equity securities, stockholders could experience significant dilution. In addition, securities issued in connection with future financing activities or potential acquisitions may have rights and preferences senior to the rights and preferences of our common stock. The issuance of shares of our common stock upon the exercise of options outstanding under employee benefit plans may result in dilution to our stockholders.

We do not intend to pay cash dividends. Any return on investment may be limited to the value of our common stock, if any.

We have never declared or paid cash dividends on our capital stock (other than certain dividends that may have been paid by CKST in or before 2005). We currently expect to use available funds and any future earnings to develop, operate and expand our business and do not anticipate paying any cash dividends in the foreseeable future. In addition, the terms of any future debt or credit facility we may obtain may preclude us from paying any dividends. As a result, capital appreciation, if any, of our common stock will be an investor's only source of potential gain from our common stock for the foreseeable future.

Our Certificate of Incorporation grants our Board of Directors the power to designate and issue additional shares of common and/or preferred stock.

Our authorized capital consists of 750,000,000 shares of common stock and 50,000,000 shares of preferred stock. Our preferred stock may be designated into series pursuant to authority granted by our Certificate of Incorporation, and on approval from our Board of Directors. The Board of Directors, without any action by our stockholders, may designate and issue shares in classes or series as the Board of Directors deems appropriate and establish the rights, preferences and privileges of those shares, including dividends, liquidation and voting rights. The rights of holders of other classes or series of stock that may be issued could be superior to the rights of holders of our common shares. The designation and issuance of shares of capital stock having preferential rights could adversely affect other rights appurtenant to shares of our common stock. Furthermore, any issuances of additional stock (common or preferred) will dilute the percentage of ownership interest of then-current holders of our capital stock and may dilute our book value per share.

#### Item 1B. Unresolved Staff Comments

Not Applicable.

#### Item 2. Properties

As of December 31, 2010, we lease a warehouse facility in Van Nuys, California (near Los Angeles) under a month-to-month operating lease. We also lease office and warehouse facilities in Clifton, New Jersey (near New York City) under an operating lease that expires in August 2012. We believe our facilities are adequate for our needs.

Item 3. Legal Proceedings

From time to time, we may be a party to legal proceedings incidental to our business. We do not believe that there are any proceedings threatened or pending against us, which, if determined adversely to us, would have a material effect on our financial position or results of operations and cash flows.

Item 4. (Removed and Reserved)

PART II

Item 5. Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities

Market for Common Stock

The Company's common stock currently trades on the OTC Bulletin Board under the symbol "CDOM.OB." The following table sets forth the quarterly high and low sales prices of our common stock for the fiscal years 2010 and 2009, as quoted on the OTC Bulletin Board. This information represents prices between dealers and does not include retail mark-ups, markdowns or commissions and may not represent actual transactions. All information related to stock price and numbers of common stock are post-split, which reflect a reverse split with clickNsettle.com which occurred in March of 2008.

|                  | High | Low    |
|------------------|------|--------|
| Fiscal Year 2009 |      |        |
| First Quarter    |      | \$2.25 |
|                  |      | \$0.52 |
| Second Quarter   |      | \$1.49 |
|                  |      | \$0.65 |
| Third Quarter    |      | \$1.15 |
|                  |      | \$0.60 |
| Fourth Quarter   |      |        |

\$1.80

\$0.35

Fiscal Year 2010

First Quarter

\$0.96

\$0.40

Second Quarter

\$0.98

\$0.40

Third Quarter

\$0.60

\$0.19

Fourth Quarter

\$0.29

\$0.04

As of March 18, 2011, there were approximately 254 registered holders of record of the common stock.

We have not paid any cash dividends on our common stock and do not plan to pay any such dividends in the foreseeable future. Our Board of Directors will determine our future dividend policy on the basis of many factors, including results of operations, capital requirements and general business conditions.

Recent Sales of Unregistered Securities; Use of proceeds From Registered Securities.

None.

Item 6. Selected Financial Data

Not Applicable.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The discussion and analysis of our financial condition and results of operations are based on our financial statements, which we have prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported revenues and expenses during the reporting periods. On an ongoing basis, we evaluate estimates and judgments, including those described in greater detail below. We base our estimates on historical experience and on various other factors that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

As used in this "Management's Discussion and Analysis of Financial Condition and Results of Operation," except where the context otherwise requires, the term "we," "us," "our" or "Cardo" refers to the business of Cardo Medical, Inc.

## Overview

Cardo Medical, Inc. is an orthopedic medical device company specializing in designing, developing and marketing high performance reconstructive joint devices and spinal surgical devices. Reconstructive joint devices are used to replace knee, hip and other joints that have deteriorated through disease or injury. Spinal surgical devices involve products to stabilize the spine for fusion and reconstructive procedures. Within these areas, we are focused on developing surgical devices, instrumentation and techniques that will enable surgeons to move what are typically inpatient surgical procedures to the outpatient world. We commercialize our reconstructive joint devices through our Reconstructive Division and our spine devices through our Spine Division. We launched and commenced sales of our first product in late 2006, which was a high performance unicompartmental knee replacement. We commenced sales of our other reconstructive products in 2007 and our spine products in 2008.

As discussed below, in January 2011 we entered into an asset purchase agreement to sell substantially all of our assets in the Reconstructive Division to Arthrex. We expect to complete the sale of the Reconstructive Division assets during the second quarter of 2011. Additionally, we are currently in negotiations for the sale of substantially all of the assets in the Spine Division. Management anticipates that the sale of substantially all of the assets of its Spine Division will be completed during the second quarter of 2011. However, if the sale of the Reconstructive Division assets or Spine Division assets is not consummated, our cash position would require that we immediately raise working capital or cease operations.

## Critical Accounting Policies and Estimates

Our significant accounting policies are more fully described in the notes to our consolidated financial statements. Those material accounting estimates that we believe are the most critical to an investor's understanding of our financial results and condition are discussed immediately below and are particularly important to the portrayal of our financial position and results of operations and require the application of significant judgment by our management to determine the appropriate assumptions to be used in the determination of certain estimates.

## Use of Estimates

Financial statements prepared in accordance with United States generally accepted accounting principles, which we refer to as U.S. GAAP, require management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Among other things, management makes estimates relating to allowances for doubtful accounts, excess and obsolete inventory items, the estimated depreciable lives of property and equipment, the impairment of goodwill and other intangible assets, share-based payment, deferred income tax assets and the allocation of the purchase price paid for the minority interests in Uni, Cervical and Accelerated Innovation. Given the short operating history of Cardo, actual results could differ from those estimates.

## Discontinued Operations

On October 7, 2010, the Company's management and Board of Directors decided to put substantially all of its assets up for sale. The assets determined to be held for sale were inventories, intellectual property, and property and equipment of its Reconstructive Division and Spine Division. The Company decided to put up for sale the assets of its Reconstructive Division and Spine Division primarily because it did not have sufficient working capital, and was not able to procure such financial resources through equity or debt financing, in order to fully execute a profitable sales strategy. In January 2011, the Company entered into an Asset Purchase Agreement with Arthrex to sell the inventory

and equipment relating to the Reconstructive Division for cash consideration of approximately \$9.9 million, plus the carrying value of the Reconstructive Division inventory and equipment, which is expected to approximately \$4.7 million. The Asset Purchase Agreement also calls for the Company to receive a royalty of 5% of future net sales of the Reconstructive products made by Arthrex for the next 20 years after the closing date. As a

result, the Company expects to record a gain on the sale of these assets in 2011, and no loss has been reflected in 2010. The transactions contemplated by the Asset Purchase Agreement with Arthrex are expected to close during the second quarter of 2011. The Company remains in negotiations to sell substantially all of the assets of its Spine Division. Management anticipates that the sale of substantially all of the assets of its Spine Division will be completed during the second quarter of 2011.

As a result of the factors discussed above, the Company's two business segments have been discontinued and no continuing cash flows are expected to be generated subsequent to the expected disposal dates above. In addition, there will be no significant continuing involvement by the Company in the operations of the discontinued operations.

Total sales associated with the discontinued Reconstructive Division and Spine Division reported as discontinued operations for the years ended December 31, 2010 and 2009, were \$3,312,000 and \$1,869,000, respectively. The total pretax loss associated with the discontinued Reconstructive Division and Spine Division, including the discontinued corporate support for those activities, reported as discontinued operations for the years ended December 31, 2010 and 2009, were \$10,953,000 and \$4,552,000, respectively. The only continuing operations reflected are expenses associated with business insurance, legal and accounting fees which the Company will continue to incur. The Company will also be receiving future royalty payments resulting from the Asset Purchase Agreement with Arthrex. As a result, the Company will have administrative costs associated with the receipt and maintenance of any future royalty revenue. The prior year financial statements for 2009 have been reclassified to present the operations of the Reconstructive Division and Spine Division as discontinued operations.

The assets of the discontinued operations are presented separately under the caption "Assets held for Sale" in the accompanying consolidated balance sheet at December 31, 2010 and 2009 and consisted of the following.

| (In thousands)         | <u>2010</u>     | <u>2009</u>     |
|------------------------|-----------------|-----------------|
| Inventories            | \$ 2,990        | \$ 3,256        |
| Property and equipment | 1,775           | 1,228           |
| Intangible assets      | -               | 4,353           |
|                        | <u>\$ 4,765</u> | <u>\$ 8,837</u> |

There was no gain or loss associated with the recording of the assets held for sale, which are recorded at the lower of their carrying amounts or fair values less cost to sell.

#### Revenue Recognition

We recognize revenue when it's realizable and earned. Management considers revenue to be realizable and earned when the following criteria are met: persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the seller's price to the buyer is fixed or determinable, and collectability is reasonably assured.

Persuasive evidence of the arrangements occurs when we receive a signed contract from the hospital in which the surgery will be performed. Within that contract is the price at which the hospital will buy the device. Delivery occurs on the day of surgery when the device is implanted by the surgeon. Collectability is reasonably assured as we have continuing relationships with the hospitals and can pursue collections if necessary. As we do not accept returns and do not have any post-sale obligations, the date of revenue recognition is on the date of surgery.

#### Goodwill and Other Intangible Assets

Goodwill represents the excess of purchase price over fair value of tangible net assets of acquired businesses after amounts allocated to other intangible assets. Other intangible assets include a royalty agreement, developed

technology and customer relationships which are amortized on a straight-line basis over 2 to 10 years.

## Goodwill and Long-Lived Assets Impairment

Goodwill and long-lived assets are assessed for impairment annually or more frequently if events or circumstances occur that indicate that the carrying amount of the assets may not be recoverable. Cardo conducts its annual evaluations for impairment at the end of the fourth quarter of each year. The Company concluded that there were no such events or changes in circumstances during 2009; however, during the quarter ended September 30, 2010, the changes in Cardo's financial condition and continued inability to raise sufficient funds in order to fully execute a profitable sales strategy indicated the carrying values of its goodwill and other intangible assets may not be recoverable. Goodwill impairment testing is based on a two step process, where the first step compares the fair value of the reporting unit to the carrying value of the unit. If the first step test indicates impairment, the second step test compares the fair value of a reporting unit with its carrying value using discounted cash flow projections. Long-lived asset impairment testing compares the projected undiscounted future cash flows associated with the related assets over their estimated useful lives against their respective carrying amount. Impairment, if any, is based on the excess of the carrying amount over the fair value, based on market value when available, or discounted expected cash flows, of those assets and is recorded in the period in which the determination is made. These evaluations require us to make certain assumptions and estimate future revenues and profitability.

During the quarter ended September 30, 2010, the Company's management performed an assessment of its goodwill and other intangible assets for impairment. The Company's management determined that the fair value of the knee and hip reporting units were not in excess of the corresponding assets' carrying value as of September 30, 2010 and recorded a non-cash impairment charge of \$4,050,000 relating to other intangible assets during the quarter then ended. In addition, management recorded a non-cash impairment charge of \$1,233,000 against the goodwill associated with the knee and hip reporting units. The total impairment charge for the year ended December 31, 2010 amounted to \$5,283,000. The remaining value of goodwill and other intangible assets as of December 31, 2010 was \$0.

Based on the assessments performed for the year ended December 31, 2009, the Company determined that the fair value of the knee and hip reporting units were in excess of the corresponding assets' carrying value as of December 31, 2009. Accordingly, no impairment charges were recorded for the year ended December 31, 2009.

## Property and Equipment

Property and equipment are recorded at historical cost and depreciated on a straight-line basis over their estimated useful lives, which range from three to five years. When items are retired or disposed of, income is charged or credited for the difference between the net book value of the asset and the proceeds realized thereon. Ordinary maintenance and repairs are charged to expense as incurred, and replacements and betterments are capitalized.

As a result of the Company announcing it was placing substantially all of its assets up for sale in October 2010, all depreciation on property and equipment stopped as of the announcement date. In addition, as of December 31, 2010, the carrying value of all property and equipment has been classified as assets held for sale in the accompanying consolidated balance sheets.

## Share Based Payment

In order to determine compensation on options issued to consultants, and employees' options, the fair value of each option granted is estimated on the date of grant using the Black-Scholes option-pricing model. Management estimates the requisite service period used in the Black-Scholes calculation based on an analysis of vesting and exercisability conditions, explicit, implicit, and/or derived service periods, and the probability of the satisfaction of any performance or service conditions. Management also considers whether the requisite service has been rendered when recognizing compensation costs. Expected volatilities are based on the historical volatility of the components of the small cap sector of the Dow Jones medical equipment index for a period equal to the expected life of our options. We also measure the volatility of other public companies with similar size and industry characteristics to us for the same

period. These measurements are averaged and the result is used as expected volatility. As there is no history of option lives at our company, the expected term of options granted is the midpoint between the vesting periods and the contractual life of the options. The risk-free rate for periods within the contractual life of the option

is based on the U.S. Treasury yield curve in effect at the time of grant. The forfeiture rate is based on an analysis of the nature of the recipients' jobs and relationships to us.

#### Income Taxes

Deferred income tax assets and liabilities are recognized to reflect the estimated future tax effects, calculated at currently effective tax rates, of future deductible or taxable amounts attributable to events that have been recognized on a cumulative basis in the financial statements. A valuation allowance related to a deferred income tax asset is recorded when it is more likely than not that some portion of the deferred income tax asset will not be realized. Deferred income tax assets and liabilities are adjusted for the effects of the changes in tax laws and rates on the date of enactment.

The Company recognizes all material tax positions, including all significant uncertain tax positions, in which it is more likely than not that the position will be sustained based on its technical merits and if challenged by the relevant taxing authorities. At each balance sheet date, unresolved uncertain tax positions are reassessed to determine whether subsequent developments require a change in the amount of recognized tax benefit.

#### Inventory

Inventory is stated at the lower of cost or net realizable value. Cost is determined on a first-in, first-out basis; and the inventory is comprised of work in process and finished goods. Work in process consists of fabrication costs paid relating to items currently in production. Finished goods are completed knee, spine and hip replacement products ready for sales to customers.

At each balance sheet date, the Company evaluates its ending inventories for excess quantities and obsolescence. This evaluation includes an analysis of sales levels by product type. Among other factors, the Company considers current product configurations, historical and forecasted demand, market conditions and product life cycles when determining the net realizable value of the inventory. Provisions are made to reduce excess or obsolete inventories to their estimated net realizable values. Once established, write-downs are considered permanent adjustments to the cost basis of the excess or obsolete inventory. Management recorded an excess inventory reserve of \$1,620,000 during the year ended December 31, 2010. Of this amount, \$567,000 was allocable to the Reconstructive Division and \$1,053,000 was allocable to the Spine Division. The inventory reserve is recorded as a component of cost of goods sold in the accompanying consolidated statements of operations for the year ended December 31, 2010. Cardo did not have any inventory considered by management to be excess or obsolete as of December 31, 2009.

As a result of the Company announcing it was placing substantially all of its assets up for sale in October 2010, the carrying value of all property and equipment has been classified as assets held for sale in the accompanying consolidated balance sheet as of December 31, 2010.

#### Recent Accounting Pronouncements

In 2010 the Company adopted the provisions of the *Improvement to Financial Reporting by Enterprises Involved with Variable Interest Entities Topic* of the FASB Codification. The topic requires a qualitative approach to identifying a controlling financial interest in a variable interest entity (VIE) and requires ongoing assessment of whether an entity is a VIE and whether an interest in a VIE makes the holder the primary beneficiary of the VIE. The adoption of this guidance did not have a material impact on the Company's results of operations, financial position or cash flows.

In 2010 the Company adopted the provisions of the *Fair Value Measurements and Disclosures Topic "Improving Disclosures About Fair Value Measurements"* of the FASB Codification. This topic requires companies to make new disclosures about recurring and nonrecurring fair value measurements, including significant transfers into and out of Level 1 and Level 2 fair value measurements, and information on purchases, sales, issuances, and settlements on a

gross basis in the reconciliation of Level 3 fair value measurements. The adoption of this guidance did not have a material impact on the Company's results of operations, financial position or cash flows.

In 2009 the FASB amended the provisions of the *Revenue Recognition for Multiple-Deliverable Revenue Arrangements Topic* of the FASB Codification. This topic amends prior guidance and requires an entity to apply the relative selling price allocation method in order to estimate the selling price for all units of accounting, including delivered items, when vendor-specific objective evidence or acceptable third-party evidence does not exist. These provisions are effective for revenue arrangements entered into or which contain material modifications in fiscal years beginning on or after June 15, 2010, applied prospectively. This topic is effective for the Company beginning on January 1, 2011. The Company does not expect the adoption of the topic to have a material impact on its consolidated financial statements.

#### Results of Operations and Financial Condition for the Year Ended December 31, 2010 as Compared to the Year Ended December 31, 2009

The following are the consolidated results of our operations for the year ended December 31, 2010 compared to the year ended December 31, 2009. As discussed above, our Reconstructive Division and Spine Division were discontinued during 2010. For purposes of this discussion and analysis, the below consolidated statement of operations include the results of all operations. The consolidated statements of operations in our accompanying consolidated financial statements reflect these amounts as discontinued operations.

| (In thousands)                               | Years Ended<br>December 31, |          | \$ Change | % Change |
|--|-----------------------------|----------|-----------|----------|
|  | 2010                        | 2009     |           |          |
| Net sales                                    | \$ 3,312                    | \$ 1,869 | \$ 1,443  | 77.2%    |
| Cost of sales                                | 2,324                       | 380      | 1,944     | 511.6%   |
| Gross profit                                 | 988                         | 1,489    | (501)     | -33.6%   |
| Research and development expenses            | 859                         | 1,003    | (144)     | -14.4%   |
| Selling, general and administrative expenses | 6,382                       | 5,588    | 794       | 14.2%    |
| Impairment charges                           | 5,283                       | -        | 5,283     | 100.0%   |
| Loss from operations                         | (11,536)                    | (5,102)  | (6,434)   | 126.1%   |
| Interest income (expense), net               | 27                          | 24       | 3         | 12.5%    |
| Loss before income tax provision             | (11,509)                    | (5,078)  | (6,431)   | 126.6%   |
| Provision for income taxes                   | -                           | -        | -         | 100.0%   |
| Net loss                                     | (11,509)                    | (5,078)  | (6,431)   | 126.6%   |

#### Revenues

Net sales for the year ended December 31, 2010 increased by \$1,443,000, or 77.2%, as compared to 2009. Revenue in our Reconstructive Division, including our knee, hip and patellofemoral products, increased by \$668,000 in 2010, or 43.4%, as compared to 2009. Revenue in our Spine Division, including our spinal lumbar fusion, cervical plate and screw systems, and interbody spinal devices, increased by \$775,000 in 2010, or 235.6%, as compared to 2009.

We experienced substantial growth in Spine Division sales due to wider acceptance of the products by back surgeons. In addition, we also introduced interbody spinal devices during the first quarter of 2010, which was a major contributor to the increase in Spine sales. Interbody spinal sales increased by approximately \$380,000 in 2010.

Our Reconstructive Division sales also increased due to the wider acceptance of our hip products by orthopedic surgeons. In particular, our total knee product sales were \$487,000 in 2010 compared to \$31,000 in 2009, representing an increase of \$456,000. Our Reconstructive Division accounted for 66.7% of net sales and the Spine Division

accounted for 33.3% of net sales for the year ended December 31, 2010. In 2009, the Reconstructive Division and Spine Division accounted for 82.4% and 17.6%, respectively, of net sales.

Despite the growth in sales of the above products, the Company was unable to obtain the necessary debt or equity financing to fund the future growth of the operations. As a result, as described above, we announced the decision in October 2010 to put substantially all of our assets up for sale. Upon the completion of the sale of substantially all of our assets, our primary source of revenue is expected to be royalty revenue related to the Asset Purchase Agreement with Arthrex.

#### Gross Profit and Cost of Sales

Cost of sales for the year ended December 31, 2010 increased by \$1,944,000, or 511.6%, as compared to 2009 primarily due to increased sales volume on the products mentioned above, as well as a reserve for excess inventory of \$1,620,000 during 2010.

Our gross profit percentage for 2010 was 29.8%, representing a decrease from 79.7% in 2009. The primary reason for this decrease is the \$1,620,000 inventory reserve recorded in 2010, \$567,000 of which was allocated to the Reconstructive Division and \$1,053,000 was allocated to the Spine Division. Excluding the impact of the inventory reserve, the gross profit percentage in 2010 was 78.7%, which was consistent with the percentage of 79.7% in 2009.

Excluding the impact of the inventory reserve, the gross profit percentages for the Reconstructive Division and Spine Division for 2010 amounted to 79.2% and 77.9%, respectively. During 2009, the gross profit percentages for the Reconstructive Division and Spine Division amounted to 78.8% and 83.6%, respectively. The reason for the decrease in the gross profit percentage for the Spine Division in 2010 was due primarily to the sales of our interbody spinal devices which were introduced in 2010. The gross profit percentage earned on these products in 2010 amounted to 75.4%, which was lower than the other Spine products.

#### Research and Development Expenses

Research and development expenses for the year ended December 31, 2010 decreased by \$144,000, or 14.4%, as compared to 2009. The decrease in 2010 was due primarily to decreases in expenses associated with labor costs and prototype costs. These decreases were due mainly to the announcement in October 2010 of the planned sale of significantly all of our assets. As a result, all research and development activity was minimized from that point forward. Research and development activities are expected to be minimal during 2011.

#### Selling, General and Administrative Expenses

Selling, general and administrative expenses for the year ended December 31, 2010 increased by \$794,000, or 14.2%, as compared to 2009. Sales commissions increased by \$505,000 in 2010, which was driven by higher sales volume and commission rates on certain products. In addition, professional and consulting fees increased approximately \$203,000 during 2010, as a result of exploring strategic opportunities, expanding corporate activities and more regulatory filings during the year. Also, our salary and payroll expenses increased by approximately \$236,000 due to the increase in sales employees during the first 9 months of 2010, prior to the announcement of the planned discontinuance of operations in October 2010. These increases were offset by a decrease in depreciation and amortization expense of \$240,000 in 2010. We stopped recording depreciation and amortization expense as a result of the Company announcing it was placing substantially all of its assets up for sale in October 2010. Upon the completion of the sale of substantially all of our assets, we expect our selling, general and administrative expenses to consist primarily of insurance, accounting and legal fees associated with remaining a public company.

#### Impairment Expenses

During 2010, we performed an assessment of our goodwill and other intangible assets for impairment. We determined that the carrying value of the other intangible assets for the knee and hip reporting units were in excess of their corresponding fair values, and recorded a non-cash impairment charge of \$4,050,000 relating to other intangible

assets. In addition, management recorded a non-cash impairment charge of \$1,233,000 against the goodwill associated with the knee and hip reporting units. The total impairment charge for the year ended December 31, 2010 amounted to \$5,283,000. There was no such charge recorded during 2009. This impairment charge was made based on available information at the time during the third quarter of 2010, prior to the purchase offer received from Arthrex.

### Interest Income (Expense)

Net interest and other income for the year ended December 31, 2010 increased by \$3,000, or 12.5%, as compared to 2009. Interest income during 2010 amounted to approximately \$11,000, along with other income of \$30,000 relating to the sale of certain instruments. These amounts were offset by interest expense of approximately \$14,000 relating to short-term borrowings. Interest income in 2009 amounted to \$24,000, and was higher than 2010 due to excess cash on-hand being higher during 2009. We had no interest expense during 2009.

### Liquidity and Capital Resources

Net cash used in operating activities was approximately \$4.3 million for the year ended December 31, 2010 as compared to approximately \$4.8 million for the year ended December 31, 2009. The most significant uses of cash during 2010 related to the build-up of inventory levels, which increased by \$1,354,000, as well as the payment of salaries, professional services and research and development costs.

Net cash used in investing activities was approximately \$1.1 million for the year ended December 31, 2010 as compared to approximately \$2.4 million for the year ended December 31, 2009. During 2010, we spent \$1.1 million on the acquisition of property and equipment. In 2009, we purchased substantially all of the assets of Vertebron, Inc., primarily their spine inventories, for \$1.3 million and added over \$1 million of instrumentation and other property and equipment.

Our net cash provided by financing activities was \$500,000 during the year ended December 31, 2010, as compared to approximately \$9 million for the year ended December 31, 2009. During 2010, we had proceeds from short-term promissory notes payable for \$500,000. During 2009, we completed a private placement in June that provided nearly \$3.1 million, net of direct costs, and another private placement in November for approximately \$5.9 million, net of direct costs. Subsequent to December 31, 2010, we entered into the Arthrex Note and as of March 22, 2011, we have borrowed a total of \$972,000 under the Arthrex Note. Of the amount borrowed, \$522,000 was used to pay off the Brooks Note and Brien Note (see Note 3 in the accompanying consolidated financial statements) and \$450,000 was utilized to pay for vendors of inventory.

Our available funds are not projected to meet all of our working capital needs for the next twelve months. On January 24, 2011, we entered into an Asset Purchase Agreement to sell all of the assets related to the Reconstructive Division for total cash consideration of approximately \$14.6 million (see Note 10 in the accompanying consolidated financial statements). The sale is expected to close during the second quarter of 2011. The Company has begun negotiations with an unaffiliated third party for the sale of substantially all of the assets of the Spine Division. Management anticipates that the sale of substantially all of the assets of its Spine Division will be completed during the second quarter of 2011. However, there is no guarantee that we will successfully close the sale of our Reconstructive Division assets or Spine Division assets as planned. If the sale of the Reconstructive Division assets or Spine Division assets is not consummated, our cash position would require that we immediately raise working capital or cease operations.

### Off-Balance Sheet Arrangements

We have no off-balance sheet financing arrangements.

Contractual Obligations

We have contractual operating lease obligations on our warehouse and office facilities in Clifton, New Jersey whose aggregate minimum annual payments are as follows for the years ending December 31.

|                |    |     |
|----------------|----|-----|
| (In thousands) |    |     |
| 2011           | \$ | 98  |
| 2012           |    | 66  |
|                |    | 164 |
|                | \$ | 164 |

Forward Looking Statements

Our business, financial condition, results of operations, cash flows and prospects, and the prevailing market price and performance of our common stock, may be adversely affected by a number of factors, including the matters discussed in "Risk Factors". Certain statements and information set forth in this Annual Report on Form 10-K, as well as other written or oral statements made from time to time by us or by our authorized executive officers on our behalf, constitute "forward-looking statements." You should note that our forward-looking statements speak only as of the date of this Annual Report on Form 10-K or when made and we undertake no duty or obligation to update or revise our forward-looking statements, whether as a result of new information, future events or otherwise. Although we believe that the expectations, plans, intentions and projections reflected in our forward-looking statements are reasonable, such statements are subject to known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. The risks, uncertainties and other factors that should be considered are included in "Risk Factors" beginning on page 13.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Not Applicable.

Item 8. Financial Statements and Supplementary Data

Cardo Medical, Inc.

For the Years Ended December 31, 2010 and 2009

Documents filed as part of this Annual Report on Form 10-K:

Reports of Independent Registered Accounting Firm for the years ended December 31, 2010 and 2009

Financial Statements

Consolidated Balance Sheets at December 31, 2010 and 2009

Consolidated Statements of Operations for the years ended December 31, 2010 and 2009

Consolidated Statements of Stockholders' Equity for the years ended December 31, 2010 and 2009

Consolidated Statements of Cash Flows for the years ended December 31, 2010 and 2009

Notes to Consolidated Financial Statements



Report of Independent Registered Public Accounting Firm

To the Audit Committee of the  
Board of Directors and Shareholders  
of Cardo Medical, Inc.

We have audited the accompanying consolidated balance sheet of Cardo Medical, Inc. (the "Company") as of December 31, 2010, and the related consolidated statements of operations, changes in stockholder's equity and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements 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 the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Cardo Medical, Inc. as of December 31, 2010, and the consolidated results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, the Company has continuing losses from operations, negative cash flows and limited cash to fund future operations. These matters raise a substantial doubt about the Company's ability to continue as a going concern. Management's plans concerning these matters are also described in Note 1. These financial statements do not include any adjustments relating to the recoverability and classification of recorded assets, or amounts and classification of liabilities that might be necessary from the outcome of this uncertainty.

/s/ Marcum LLP

Los Angeles, CA  
March 31, 2011

Report of Independent Registered Public Accounting Firm

To the Audit Committee of the  
Board of Directors and Shareholders  
of Cardo Medical, Inc.

We have audited the accompanying consolidated balance sheet of Cardo Medical, Inc. (the "Company") as of December 31, 2009, and the related consolidated statement of operations, changes in stockholder's equity and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements 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 the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Cardo Medical, Inc. as of December 31, 2009, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, the Company has losses from operations, negative cash flows from operations, an accumulated stockholders' deficit and limited cash to fund future operations. These matters, among others, raise a substantial doubt about the Company's ability to continue as a going concern. Management's plans concerning these matters are also described in Note 1. These financial statements do not include any adjustments relating to the recoverability and classification of recorded assets, or amounts and classification of liabilities that might be necessary in the event the Company cannot continue in existence.

/s/ Stonefield Josephson, Inc.

Los Angeles  
March 31, 2010

**CARDO MEDICAL, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
(in thousands, except share amounts)

|  | <b>December 31,</b> |             |
|--|---------------------|-------------|
|  | <b>2010</b>         | <b>2009</b> |
| <b>Assets</b>  |                     |             |
| Current assets   |                     |             |
| Cash   | \$ 127              | \$ 4,973    |
| Accounts receivable, net of allowance for doubtful accounts of \$51 and \$0, respectively  | 413                 | 307         |
| Prepaid expenses and other current assets  | 99                  | 65          |
|  | 639                 | 5,345       |
| Total current assets   |                     |             |
| Assets held for sale   | 4,765               | 8,837       |
| Goodwill   | -                   | 1,233       |
| Deposits   | 31                  | 173         |
|  | 5,435               | 15,588      |
| Total assets   | \$ 5,435            | \$ 15,588   |
| <b>Liabilities and Stockholders' Equity</b>  |                     |             |
| Current liabilities  |                     |             |
| Accounts payable and accrued expenses  | \$ 1,656            | \$ 851      |
| Note payable - related party   | 300                 |             |
| Note payable   | 200                 | -           |
|  | 2,156               | 851         |
| Total liabilities  |                     |             |
| Stockholders' equity   |                     |             |
| Common stock, \$0.001 par value, 750,000,000 shares authorized,<br>230,293,141 issued and outstanding as of December 31, 2010 and 2009 | 230                 | 230         |
| Additional paid-in capital   | 25,773              | 25,722      |
| Note receivable from stockholder   | (50)                | (50)        |
| Accumulated deficit  | (22,674)            | (11,165)    |
|  | 3,279               | 14,737      |
| Total stockholders' equity   |                     |             |
| Total liabilities and stockholders' equity   | \$ 5,435            | \$ 15,588   |

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

CARDO MEDICAL, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(in thousands, except share amounts)

|   | Years Ended<br>December 31, |             |
|---|-----------------------------|-------------|
|   | 2010                        | 2009        |
| Net sales   | \$ -                        | \$ -        |
| Cost of sales   | -                           | -           |
|   | -                           | -           |
| Gross profit  | -                           | -           |
| General and administrative expenses                                     | 583                         | 550         |
|   | -                           | -           |
| Loss from operations  | (583)                       | (550)       |
| Interest income, net  | 27                          | 24          |
|   | (556)                       | (526)       |
| Loss from continuing operations before income tax provision             | (556)                       | (526)       |
| Provision for income taxes  | -                           | -           |
|   | (556)                       | (526)       |
| Loss from continuing operations   | (556)                       | (526)       |
| Discontinued operations (Note 1)  |                             |             |
| Loss from operations of discontinued Reconstructive and Spine Divisions | (10,953)                    | (4,552)     |
|   | (11,509)                    | (5,078)     |
| Net loss  | \$ (11,509)                 | \$ (5,078)  |
|   | (11,509)                    | (5,078)     |
| Net loss per share:   |                             |             |
| Basic and diluted   |                             |             |
| Discontinued operations   | \$ (0.05)                   | \$ (0.02)   |
|   | (0.05)                      | (0.02)      |
| Total   | \$ (0.05)                   | \$ (0.02)   |
|   | (0.05)                      | (0.02)      |
|   | (0.05)                      | (0.02)      |
| Weighted average shares outstanding:                                    |                             |             |
| Basic and diluted   | 230,293,141                 | 207,455,258 |
|   | 230,293,141                 | 207,455,258 |
|   | 230,293,141                 | 207,455,258 |

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

CARDIO MEDICAL, INC.  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
(in thousands, except share amounts)

|   | Common Stock |        | Additional | Note        | Accumulated | Total     |
|---|--------------|--------|------------|-------------|-------------|-----------|
|   | Shares       | Amount | Paid-in    | Receivable  | Deficit     |           |
|   |              |        | Capital    | from        |             |           |
|   |              |        |            | Stockholder |             |           |
| <b>Balance, December 31, 2008</b>               | 203,360,271  | \$ 203 | \$ 16,631  | \$ (50)     | \$ (6,087)  | \$ 10,697 |
| Issuance of common stock for private placements | 26,932,870   | 27     | 8,984      | -           | -           | 9,011     |
| Fair value of vested stock option grants        | -            | -      | 107        | -           | -           | 107       |
| Net loss  | -            | -      | -          | -           | (5,078)     | (5,078)   |
| <b>Balance, December 31, 2009</b>               | 230,293,141  | 230    | 25,722     | (50)        | (11,165)    | 14,737    |
| Fair value of vested stock option grants        | -            | -      | 51         | -           | -           | 51        |
| Net loss  | -            | -      | -          | -           | (11,509)    | (11,509)  |
| <b>Balance, December 31, 2010</b>               | 230,293,141  | \$ 230 | \$ 25,773  | \$ (50)     | \$ (22,674) | \$ 3,279  |

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

**CARDO MEDICAL, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in thousands)

|  | <b>Years Ended<br/>December 31,</b> |                 |
|--|-------------------------------------|-----------------|
|  | <b>2010</b>                         | <b>2009</b>     |
| <b>Cash flows from operating activities</b>                                    |                                     |                 |
| Net loss   | \$ (11,509)                         | \$ (5,078)      |
| Adjustments to reconcile net loss to net cash used in operating activities:    |                                     |                 |
| Depreciation and amortization  | 967                                 | 1,207           |
| Stock option compensation  | 51                                  | 107             |
| Impairment charges   | 5,283                               | -               |
| Inventory reserve  | 1,620                               | -               |
| Provision for allowance for doubtful accounts                                  | 51                                  | -               |
| Changes in operating assets and liabilities:                                   |                                     |                 |
| Accounts receivable  | (157)                               | (121)           |
| Inventories  | (1,354)                             | (1,013)         |
| Prepaid expenses and other current assets                                      | (34)                                | 42              |
| Accounts payable and accrued expenses  | 805                                 | 73              |
| Net cash used in operating activities  | <u>(4,277)</u>                      | <u>(4,783)</u>  |
| <b>Cash flows from investing activities</b>                                    |                                     |                 |
| Purchases of property and equipment  | (1,069)                             | (1,018)         |
| Acquisition of Vertebron, Inc. assets  | -                                   | (1,300)         |
| Increase in deposits and other assets  | -                                   | (32)            |
| Net cash used in investing activities  | <u>(1,069)</u>                      | <u>(2,350)</u>  |
| <b>Cash flows from financing activities</b>                                    |                                     |                 |
| Proceeds from private placements, net of issuance costs                        | -                                   | 9,011           |
| Proceeds from notes payable  | 500                                 | -               |
| Net cash provided by financing activities                                      | <u>500</u>                          | <u>9,011</u>    |
| Net change in cash   | (4,846)                             | 1,878           |
| Cash, beginning of year  | 4,973                               | 3,095           |
| <b>Cash, end of year</b>   | <u>\$ 127</u>                       | <u>\$ 4,973</u> |
| <i>Supplemental disclosure of cash flow information:</i>                       |                                     |                 |
| Interest paid  | \$ 4                                | \$ -            |
| Income taxes paid  | \$ -                                | \$ -            |
| <i>Supplemental disclosure of non-cash investing and financing activities:</i> |                                     |                 |
| Asset acquisition (See Note 4):  |                                     |                 |
| Assets acquired  | \$ -                                | \$ 1,300        |
| Cash consideration for assets acquired   | \$ -                                | \$ 1,300        |

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



CARDO MEDICAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2010

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Cardo Medical, Inc. ("Cardo" or the "Company") is an orthopedic medical device company specializing in designing, developing and marketing high performance reconstructive joint devices and spinal surgical devices. Reconstructive joint devices are used to replace knee, hip and other joints that have deteriorated through disease or injury. Spinal surgical devices involve products to stabilize the spine for fusion and reconstructive procedures. Within these areas, we are focused on developing surgical devices, instrumentation and techniques that will enable surgeons to move what are typically inpatient surgical procedures to the outpatient world. We commercialize our reconstructive joint devices through our reconstructive division and our spine devices through our spine division.

**Basis of Presentation**

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

**Principles of Consolidation**

The consolidated financial statements include the accounts of Cardo, Accelerated Innovation, Inc. ("Accelerated"), Uni-Knee LLC ("Uni") and Cervical Xpand LLC ("Cervical"). All significant intercompany transactions have been eliminated in consolidation.

**Discontinued Operations**

On October 7, 2010, the Company's management and Board of Directors decided to put substantially all of its assets up for sale. The assets determined to be held for sale were inventories, intellectual properties, and property and equipment of its reconstructive products (the "Reconstructive Division") and spine products (the "Spine Division"). The Company decided to put up for sale the assets of its Reconstructive and Spine Divisions primarily because it did not have sufficient working capital, and was not able to procure such financial resources through equity or debt financing, in order to fully execute a profitable sales strategy. We expect the sale of the Reconstructive Division will occur during the second quarter of 2011; however, the Company remains in negotiations to sell substantially all of the assets of its Spine Division. Management anticipates that the sale of substantially all the assets of its Spine Division will be completed during the second quarter of 2011.

As a result of the factors discussed above, the Company's two business segments have been discontinued and no continuing cash flows are expected to be generated subsequent to the expected disposal dates above. In addition, there will be no significant continuing involvement by the Company in the operations of the discontinued operations.

Total sales associated with the discontinued Reconstructive and Spine Divisions reported as discontinued operations for the years ended December 31, 2010 and 2009, were \$3,312,000 and \$1,869,000, respectively. The total pretax loss associated with the discontinued Reconstructive and Spine Divisions, including the discontinued corporate support for those activities, reported as discontinued operations for the years ended December 31, 2010 and 2009, were \$10,953,000 and \$4,552,000, respectively. The only continuing operations reflected are expenses associated with business insurance, legal and accounting fees which the Company will continue to incur. The prior year financial statements for 2009 have been reclassified to present the operations of the Reconstructive and Spine Divisions as discontinued operations.



The assets of the discontinued operations are presented separately under the caption "Assets held for Sale" in the accompanying consolidated balance sheet at December 31, 2010 and 2009 and consisted of the following.

| (In thousands)         | <u>2010</u>     |  | <u>2009</u>     |
|------------------------|-----------------|--|-----------------|
| Inventories            | \$ 2,990        |  | \$ 3,256        |
| Property and equipment | 1,775           |  | 1,228           |
| Intangible assets      | -               |  | 4,353           |
|                        | <u>\$ 4,765</u> |  | <u>\$ 8,837</u> |

There was no gain or loss associated with the recording of the assets held for sale, which are recorded at the lower of their carrying amounts or fair values less cost to sell.

#### Management's Plan

As reflected in the accompanying financial statements, during the year ended December 31, 2010, the Company had a net loss of \$11,509,000 and negative cash flows from operations of \$4,277,000. The Company also had an accumulated deficit of \$22,674,000 and had limited cash to fund its future operations. As discussed above, the Company was unable to obtain financing through debt or equity instruments in order to fund its future operations. As a result, on October 7, 2010, the Company's management and Board of Directors announced the decision to put substantially all of its assets up for sale. These factors raise substantial doubt about the Company's ability to continue as a going concern.

Accordingly, management took the following measures during the fourth quarter of 2010:

- terminated over half of the Company's employees;
- had the Company's Chief Executive Officer and President forego their salaries;
- reduced office space by not renewing the corporate headquarters facility lease;
- scaled back research and development activities;
- deferred manufacturing of inventories required to build additional base-level implant banks; and
- engaged an investment adviser to assist it in seeking alternative sources of capital; including selling of some or all of the Company's assets and other strategic alternatives.

On January 24, 2011, after conducting a sale process with the help of an investment banking firm, the Company entered into an Asset Purchase Agreement to sell all of the assets related to the Reconstructive Division for total cash consideration of approximately \$14.6 million, along with royalty payments equal to 5% of future net sales of the Company's products for a term up to and including the 20th anniversary of the closing date (see Note 10). The Company expects the sale of the Reconstructive Division will occur during the second quarter of 2011. The investment banking firm is also assisting the Company in connection with its intent to sell the assets of the Spine Division. The Company has begun negotiations with an unaffiliated third party for the sale of substantially all of the assets of the Spine Division. Management anticipates that the sale of substantially all of the assets of its Spine Division will be completed during the second quarter of 2011.

In view of the matters described above, recoverability of the recorded asset amounts shown in the accompanying consolidated balance sheets are dependent upon the successful closing of the Asset Purchase Agreement with Arthrex

for the sale of the Reconstructive Division assets, as well as the Company's ability to sell the assets of its Spine Division in a timely manner. However, there is no guarantee that these sales transactions will close as expected. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or amounts and classifications of liabilities that might be necessary should the Company be unable to continue its existence.

## Use of Estimates

Financial statements prepared in accordance with U.S. GAAP require management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Among other things, management makes estimates relating to allowances for doubtful accounts, excess and obsolete inventory items, the estimated depreciable lives of property and equipment, the impairment of goodwill and other intangible assets, share-based payment, deferred income tax assets and the allocation of the purchase price paid for the minority interests in Uni, Cervical and Accelerated. Actual results could differ from those estimates.

## Cash and Cash Equivalents

Cash equivalents are comprised of certain highly liquid investments with maturities of three months or less when purchased. The Company maintains its cash in bank deposit accounts, which at times may exceed federally insured limits. Cash and cash equivalents are stated at cost, which approximates market value. The Company has not experienced any losses related to this concentration of risk.

## Accounts Receivable

The Company periodically assesses its accounts receivable for collectability on a specific identification basis. If collectability of an account becomes unlikely, an allowance is recorded for that doubtful account. Once collection efforts have been exhausted, the account receivable is written off against the allowance. The Company does not require collateral for trade accounts receivable and has not experienced any significant write-offs. As of December 31, 2010 and 2009, the Company's allowance for doubtful accounts amounted to \$51,000 and \$0, respectively.

## Inventory

Inventory is stated at the lower of cost or net realizable value. Cost is determined on a first-in, first-out basis; and the inventory is comprised of work in process and finished goods. Work in process consists of fabrication costs paid relating to items currently in production. Finished goods are completed knee, spine and hip replacement products ready for sales to customers.

At each balance sheet date, the Company evaluates its ending inventories for excess quantities and obsolescence. This evaluation includes an analysis of sales levels by product type. Among other factors, the Company considers current product configurations, historical and forecasted demand, market conditions and product life cycles when determining the net realizable value of the inventory. Provisions are made to reduce excess or obsolete inventories to their estimated net realizable values. Once established, write-downs are considered permanent adjustments to the cost basis of the excess or obsolete inventory. Management recorded an excess inventory reserve of \$1,620,000 during the year ended December 31, 2010. Of this amount, \$567,000 was allocable to the Reconstructive Division and \$1,053,000 was allocable to the Spine Division. The inventory reserve is recorded as a component of cost of goods sold in the accompanying consolidated statements of operations for the year ended December 31, 2010. Cardo did not have any inventory considered by management to be excess or obsolete as of December 31, 2009.

As of December 31, 2010, the carrying value of inventories has been classified as assets held for sale on the accompanying consolidated balance sheets (see Note 1). The amounts as of December 31, 2009 have been reclassified to conform with the current year presentation.

## Property and Equipment

Property and equipment are recorded at historical cost and depreciated on a straight-line basis over their estimated useful lives, which range from three to five years. When items are retired or disposed of, income is charged or credited

for the difference between the net book value of the asset and the proceeds realized thereon. Ordinary maintenance and repairs are charged to expense as incurred, and replacements and betterments are capitalized.

Depreciation expense for the years ended December 31, 2010 and 2009 was \$524,000 and \$506,000, respectively. Depreciation expense is included in selling, general and administrative expenses in the accompanying consolidated statements of operations.

As a result of the Company announcing it was placing substantially all of its assets up for sale in October 2010, all depreciation on property and equipment stopped as of the announcement date. In addition, as of December 31, 2010, the carrying value of all property and equipment has been classified as assets held for sale in the accompanying consolidated balance sheets. The carrying value as of December 31, 2009 has been reclassified to conform with the current year presentation.

#### Goodwill and Other Intangible Assets

Goodwill represents the excess of purchase price over fair value of tangible net assets of acquired businesses after amounts allocated to other intangible assets. Other intangible assets include a royalty agreement, developed technology and customer relationships which are amortized on a straight-line basis over 2 to 10 years. Goodwill and other intangible assets were generated when the Company acquired the non-controlling interests of Accelerated, Cervical and Uni.

Amortization expense related to the intangible assets was \$443,000 and \$650,000 for the years ended December 31, 2010 and 2009, respectively. Although the carrying value of the intangible assets as of December 31, 2010 was \$0, the carrying value as of December 31, 2009 has been reclassified to conform with the current year presentation.

#### Goodwill and Long-Lived Assets Impairment

Goodwill and long-lived assets are assessed for impairment annually or more frequently if events or circumstances occur that indicate that the carrying amount of the assets may not be recoverable. Cardo conducts its annual evaluations for impairment at the end of the fourth quarter of each year. The Company concluded that there were no such events or changes in circumstances during 2009; however, during the quarter ended September 30, 2010, the changes in Cardo's financial condition and continued inability to raise sufficient funds in order to fully execute a profitable sales strategy indicated the carrying values of its goodwill and other intangible assets may not be recoverable. Goodwill impairment testing is based on a two step process, where the first step compares the fair value of the reporting unit to the carrying value of the unit. If the first step test indicates impairment, the second step test compares the fair value of a reporting unit with its carrying value using discounted cash flow projections. Long-lived asset impairment testing compares the projected undiscounted future cash flows associated with the related assets over their estimated useful lives against their respective carrying amount. Impairment, if any, is based on the excess of the carrying amount over the fair value, based on market value when available, or discounted expected cash flows, of those assets and is recorded in the period in which the determination is made. These evaluations require us to make certain assumptions and estimate future revenues and profitability.

During the quarter ended September 30, 2010, the Company's management performed an assessment of its goodwill and other intangible assets for impairment. The Company's management determined that the fair value of the knee and hip reporting units were not in excess of the corresponding assets' carrying value as of September 30, 2010 and recorded a non-cash impairment charge of \$4,050,000 relating to other intangible assets during the quarter then ended. In addition, management recorded a non-cash impairment charge of \$1,233,000 against the goodwill associated with the knee and hip reporting units. The total impairment charge for the year ended December 31, 2010 amounted to \$5,283,000. The impairment charge was allocated to the Reconstructive Division (see Note 9). The remaining value of goodwill and other intangible assets as of December 31, 2010 was \$0. This impairment charge was made based on available information at the time during the third quarter of 2010, prior to any offers being received for purchase of the Reconstructive Division assets.

Based on the assessments performed for the year ended December 31, 2009, the Company determined that the fair value of the knee and hip reporting units were in excess of the corresponding assets' carrying value as of December 31, 2009. Accordingly, no impairment charges were recorded for the year ended December 31, 2009.



## Other Assets

In September 2007, the Company entered into an agreement with a manufacturer to market and distribute their uni-polar and mono-polar hip products. As part of this agreement, the manufacturer granted non-exclusive licenses to the Company to use certain information and improvements so that the Company may obtain regulatory approval for the products that are the subject of the agreements, and in connection with the Company's commercialization of those products. The total costs capitalized totaled \$255,000 as of December 31, 2009. The amounts are being amortized using the straight-line method over a period of five years, which represents the contractual life of the agreement. Amortization expense related to other assets was \$34,000 and \$51,000 for the years ended December 31, 2010 and 2009, respectively. In conjunction with the assessment of Cardo's other intangible assets for impairment described above, the Company's management determined that the fair value of these capitalized costs were not in excess of their carrying value and included \$107,000 in the \$4,050,000 impairment charge above. As of December 31, 2010, the remaining book value of the capitalized costs amounted to \$0.

## Fair Value of Financial Instruments

The Company has estimated the fair value amounts of its financial instruments using the available market information and valuation methodologies considered to be appropriate and has determined that the book value of the Company's accounts receivable, inventories, prepaid expenses, deposits, accounts payable and accrued expenses as of December 31, 2010 and 2009 approximate fair value.

## Share-Based Payment

The Company recognizes equity-based compensation using the fair value of stock option awards on the date of grant using an option-pricing model. Accordingly, compensation cost for stock options is calculated based on the fair value at the time of the grant and is recognized as expense over the vesting period of the instrument in general and administrative expense in the accompanying consolidated statements of operations.

## Revenue Recognition

The Company recognizes revenue when it is realizable and earned. The Company considers revenue to be realizable and earned when the following criteria are met: persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the seller's price to the buyer is fixed or determinable, and collectability is reasonably assured.

Persuasive evidence of the arrangements occurs when the Company receives a signed contract from the hospital in which the surgery will be performed. Within that contract is the price at which the hospital will buy the device. Delivery occurs on the day of surgery when the device is implanted by the surgeon. Collectability is reasonably assured as Cardo has continuing relationships with the hospitals and can pursue collections if necessary. As the Company does not accept returns and does not have any post-sale obligations, the date of revenue recognition is on the date of surgery.

## Shipping and Handling Costs

The Company delivers its products to the customers and includes these costs in revenue. The related costs are considered necessary to complete the revenue cycle. Therefore, the Company records these costs as a component of the cost of goods sold.

## Advertising Costs

The Company did not incur any advertising costs during the years ended December 31, 2010 and 2009.

Research and Development Costs

Research and development costs consist of expenditures for the research and development of new product lines and technology. These costs are primarily payroll and payroll related expenses and various sample parts. Research and development costs are expensed as incurred.

## Income Taxes

For income tax purposes, prior to June 17, 2008, Cardo and its subsidiaries were treated as non-taxable enterprises. Income or loss generated was not taxed at the entity level, but rather passed directly through to the owners' individual income tax returns. As a result, there is no provision for income tax for any period prior to this date. On June 17, 2008, Cardo voluntarily elected to become a taxable enterprise. On August 29, 2008, Cardo effected a reverse merger with clickNsettle.com, Inc. ("CKST"), and adopted CKST as the taxpaying entity.

## Net Loss Per Share

Basic net loss per share is computed by using the weighted-average number of common shares outstanding during the period. Diluted net loss per share is computed giving effect to all dilutive potential common shares that were outstanding during the period. Dilutive potential common shares consist of incremental common shares issuable upon exercise of stock options or warrants. No dilutive potential common shares are included in the computation of any diluted per share amount when a loss from continuing operations is reported by the Company because they are anti-dilutive. As of December 31, 2010 and 2009, the Company had total options of 1,961,400 and 2,036,000, respectively, which were excluded from the computation of net loss per share because they are anti-dilutive. As of December 31, 2010 and 2009, the Company had 575,613 warrants which were also excluded from the computation because they were anti-dilutive.

## Concentrations and Other Risks

As of December 31, 2010, the Company had 3 customers that accounted for 28.7%, 12.7 %, and 11.7% of its accounts receivable. The Company had 4 customers that comprised 17.4%, 15.8%, 12.3%, and 10.5% of the Company's net sales for the year ended December 31, 2010.

As of December 31, 2009, the Company had four customers that accounted for 28.2%, 15.6%, 15.4% and 10.0% of its accounts receivable. The Company had three customers that comprised 28.1%, 22.7% and 13.2% of the Company's net sales for the year ended December 31, 2009.

## Comprehensive Loss

Comprehensive loss consists solely of the Company's net loss during the years ended December 31, 2010 and 2009. As such, there is no statement of comprehensive income in these consolidated financial statements.

## Reclassifications

Certain amounts from prior periods have been reclassified to conform to the current period financial statement presentation. These reclassifications have no effect on previously reported net income.

## Recent Accounting Pronouncements

In 2010 the Company adopted the provisions of the *Improvement to Financial Reporting by Enterprises Involved with Variable Interest Entities Topic* of the FASB Codification. The topic requires a qualitative approach to identifying a controlling financial interest in a variable interest entity (VIE) and requires ongoing assessment of whether an entity is a VIE and whether an interest in a VIE makes the holder the primary beneficiary of the VIE. The adoption of this guidance did not have a material impact on the Company's results of operations, financial position or cash flows.

In 2010 the Company adopted the provisions of the *Fair Value Measurements and Disclosures Topic "Improving Disclosures About Fair Value Measurements"* of the FASB Codification. This topic requires companies to make new disclosures about recurring and nonrecurring fair value measurements, including significant transfers into and out of

Level 1 and Level 2 fair value measurements, and information on purchases, sales, issuances, and settlements on a gross basis in the reconciliation of Level 3 fair value measurements. The adoption of this guidance did not have a material impact on the Company's results of operations, financial position or cash flows.

In 2009 the FASB amended the provisions of the *Revenue Recognition for Multiple-Deliverable Revenue Arrangements Topic* of the FASB Codification. This topic amends prior guidance and requires an entity to apply the relative selling price allocation method in order to estimate the selling price for all units of accounting, including delivered items, when vendor-specific objective evidence or acceptable third-party evidence does not exist. These provisions are effective for revenue arrangements entered into or which contain material modifications in fiscal years beginning on or after June 15, 2010, applied prospectively. This topic is effective for the Company beginning on January 1, 2011. The Company does not expect the adoption of the topic to have a material impact on its consolidated financial statements.

## 2. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses consisted of the following as of December 31.

| (In thousands)            | <u>2010</u>     | <u>2009</u>   |
|---------------------------|-----------------|---------------|
| Accounts payable          | \$ 1,299        | \$ 488        |
| Accrued commissions       | 49              | 97            |
| Accrued vacation          | 41              | 73            |
| Accrued professional fees | 70              | 70            |
| Accrued payroll           | 75              | 34            |
| Accrued interest          | 10              | -             |
| Other accrued expenses    | 112             | 89            |
|                           | <u>\$ 1,656</u> | <u>\$ 851</u> |

## 3. PROMISSORY NOTES PAYABLE

In November 2010, the Company entered into two secured promissory notes (collectively, the "Notes") with two individuals (collectively, the "Lenders"). The aggregate proceeds from the Notes were \$500,000. One of the Lenders is the brother of the Company's Chief Executive Officer. The Notes matured on March 2, 2011 and March 4, 2011, respectively, which may be extended for up to 60 days by the Company, provided the Company gives the Lenders notice of such extension period at least two business days prior to the maturity date, and bear simple interest at 12% per annum.

In connection with the Notes, the Company entered into a security agreement with each lender, in which the Company granted a security interest, up to the amount of the principal and interest, in all of the Company's right, title and interest in all of the Company's assets, other than its accounts receivable.

The outstanding principal and accrued interest from the above Notes amounting to approximately \$522,000 was repaid subsequent to the year end (see Note 10).

## 4. VERTEBRON TRANSACTION

At a hearing held on September 15, 2009, Cardo, the successful bidder at an auction sale, was authorized to purchase substantially all of the assets of Vertebtron, Inc. ("Vertebtron") free and clear of all liens by the United States Bankruptcy Court for the District of Connecticut (the "Bankruptcy Court"). On September 29, 2009, the Bankruptcy Court issued an order memorializing the hearing held on September 15, 2009 (the "Order").

As a result of the Order, on September 30, 2009, Cardo entered into an Asset Purchase Agreement (the "Vertebtron Agreement") with Vertebtron, as a debtor-in-possession, to purchase substantially all of Vertebtron's assets, primarily consisting of inventories, excluding certain assets, such as accounts receivable, cash and cash equivalents as of the closing date. Pursuant to the Vertebtron Agreement, the purchase price for the assets was \$1.3 million.



As of September 30, 2009, Cardo submitted deposits required by the Bankruptcy Court totaling \$130,000. On October 1, 2009, the Company completed the transaction by wiring the \$1.17 million balance due under the Agreement. Pursuant to the Vertebron Agreement, Cardo did not establish control of the assets acquired in this transaction until full consideration was received by Vertebron.

Following management's analysis of the transaction, it was determined that the assets acquired under the Agreement would be accounted for as an asset purchase and not a business combination. Accordingly, the entire purchase price of \$1.3 million was allocated to Vertebron's spine inventory.

## 5. STOCKHOLDERS' EQUITY

Our authorized capital consists of 750,000,000 shares of common stock and 50,000,000 shares of preferred stock. Our preferred stock may be designated into series pursuant to authority granted by our Certificate of Incorporation, and on approval from our Board of Directors. As of December 31, 2009 and 2010, we did not have any preferred stock issued.

On June 30, 2009, Cardo completed a private placement with investors to purchase 8,689,319 shares of the Company's common stock, par value \$0.001 per share at a price of \$0.35 per share for aggregate gross proceeds of \$3,041,260. These shares have a 24-month lock up provision.

On October 16, 2009 we issued an additional 485,714 shares of Cardo's common stock with a 24- month lockup provision for gross proceeds of \$170,000.

On October 27, 2009, Cardo sold 9,949,276 shares of its common stock, par value \$0.001 per share, at a price of \$0.35 per share for aggregate gross proceeds of \$3,482,250 as part of a private placement for maximum gross proceeds of \$6,500,000. On November 13, 2009, the Company completed the private placement by selling an additional 7,808,561 shares of its common stock for gross proceeds of \$2,733,000. The Company filed a registration statement with the U.S. Securities and Exchange Commission to register for resale the shares and shares underlying the placement agent warrants issued under this private placement. The registration statement was declared effective on January 6, 2010.

In connection with this private placement, Cardo paid a finder's fee of 8% on a portion of the gross proceeds and granted 575,613 share purchase warrants. Each share purchase warrant entitles the holder to immediately purchase one share of the Company's common stock at an exercise price of \$0.44 per share and expires on November 13, 2014. The placement agent is a related party through a significant common shareholder.

The warrants had an estimated fair value of \$552,000 using the Black-Scholes option pricing method. The assumptions used in the model were as follows: volatility - 303%, discount rate - 2.28%, dividends - none, and expected term of award - 5 years.

## 6. INCOME TAXES

The items accounting for the difference between income taxes computed at the federal statutory rate and the provision for income taxes were as follows:

| (In thousands)                      | <u>2010</u> | <u>2009</u> |
|-------------------------------------|-------------|-------------|
| Statutory federal income tax rate   | 34%         | 34%         |
| State taxes, net of federal benefit | 6%          | 6%          |
| Permanent differences               | -1%         | 3%          |
| Change in valuation allowance       | -39%        | -43%        |

0%

0%

58

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Significant components of deferred income tax assets and liabilities are as follows:

| (In thousands)                   | <u>2010</u>  | <u>2009</u>  |
|----------------------------------|--------------|--------------|
| Net operating loss carryforwards | \$ 5,443     | \$ 3,574     |
| State income taxes               | (606)        | (265)        |
| Impairment charges               | 2,263        | -            |
| Allowance for doubtful accounts  | 22           | -            |
| Inventory reserve                | 694          | -            |
| Depreciation and amortization    | 169          | 188          |
| Non-qualified stock options      | 68           | 46           |
| Other                            | -            | 6            |
|                                  | <u>8,053</u> | <u>3,549</u> |
| Total, net                       | 8,053        | 3,549        |
| Valuation allowance              | (8,053)      | (3,549)      |
|                                  | <u>-</u>     | <u>-</u>     |
| Deferred tax assets, net         | \$ -         | \$ -         |

At December 31, 2010, the Company has Federal and State net operating loss carryforwards ("NOL") available to offset future taxable income of approximately \$12,718,000 and \$12,655,000, respectively. These NOL's will begin to expire in the years ending December 31, 2028 and 2018, respectively. The Company's NOL in California is currently suspended and is not available for use in 2011. These NOL's may be subject to various limitations on utilization based on ownership changes in the prior years under Internal Revenue Code Section 382. Based on its analysis, management does not believe that an ownership change has occurred that would trigger such a limitation.

Cardo periodically evaluates the likelihood of the realization of deferred tax assets, and adjusts the carrying amount of the deferred tax assets by the valuation allowance to the extent the future realization of the deferred tax assets is not judged to be more likely than not. Management considers many factors when assessing the likelihood of future realization of the Company's deferred tax assets, including its recent cumulative earnings experience by taxing jurisdiction, expectations of future taxable income or loss, the carryforward periods available to Cardo for tax reporting purposes, and other relevant factors.

At December 31, 2010 and 2009, based on the weight of available evidence, management determined that it was unlikely that the Company's deferred tax assets would be realized and have provided for a full valuation allowance associated with the net deferred tax assets.

The Company periodically analyzes its tax positions taken and expected to be taken and has determined that since inception there has been no need to record a liability for uncertain tax positions.

The Company classifies income tax penalties and interest, if any, as part of selling, general and administrative expenses in the accompanying consolidated statements of operations. There was no accrued interest or penalties as of December 31, 2010 or 2009.

The Company is neither under examination by any taxing authority, nor has it been notified of any impending examination. Due to the Company's recognition of losses since inception, all of the Company's reporting periods are effectively open to examination by the applicable tax authorities.

## 7. SHARE BASED PAYMENT

On August 29, 2008, the Company issued options to certain employees and Board members to purchase membership units in Cardo. On the same day, Cardo completed the reverse merger transaction with CKST, in which the options converted to options to purchase common shares in CKST. The Company conducted an analysis of the fair value of the options immediately prior to the reverse merger, and immediately after the reverse merger and concluded that

there is no change in value as a result of the reverse merger. Therefore, no additional compensation cost will be recognized related to the reverse merger.

The options granted give the grantees the right to purchase up to 2,398,400 shares of common stock at an exercise price of \$0.23 per share. The options vest 20% each year over a five year period and expire after ten years. The weighted average grant date fair value of options granted was \$0.13 per option, for a total fair value of approximately \$300,000 which will be reflected as an operating expense over the vesting period of the options. The total expense recognized during the years ended December 31, 2010 and 2009 in the consolidated statements of operations was \$51,000 and \$107,000, respectively. There were no options granted during the year ended December 31, 2009 or 2010.

The fair value of each option award was estimated on the date of grant using the Black-Scholes option valuation model. Because the Black-Scholes option valuation model incorporate ranges of assumptions for inputs, those ranges are disclosed. To estimate volatility of the options over their expected terms, the Company measured the historical volatility of the components of the small cap sector of the Dow Jones medical equipment index for a period equal to the expected life of the Cardo options. It also measured the volatility of other public companies with similar size and industry characteristics to Cardo for the same period. These measurements were averaged and the result was used as expected volatility. As there was no history of option lives at Cardo, the expected term of options granted was the midpoint between the vesting periods and the contractual life of the options. The risk-free rate for periods within the contractual life of the option was based on the U.S. Treasury yield curve in effect at the time of grant. The forfeiture rate was based on an analysis of the nature of the recipients' jobs and relationships to the Company. As a result of the announced sale of substantially all of the Company's assets in October 2010 (see Note 1), other than the CEO and COO, Cardo will no longer have any employees once the sale is completed. As a result, the only options expected to vest are those held by the Company's Board of Directors, CEO and COO, who are expected to remain with the continuing entity. As a result, the estimated forfeiture rate has been adjusted to 75.6%.

A summary of option activity as of December 31, 2010 and 2009, and changes during the years then ended is presented below.

|   | Options   |    | Weighted-Average<br>Exercise<br>Price | Weighted-Average<br>Remaining<br>Contractual<br>Life (Years) |    | Aggregate<br>Intrinsic<br>Value |
|---|-----------|----|---------------------------------------|--|----|---------------------------------|
| Outstanding at December 31, 2008                    | 2,398,400 | \$ | 0.23                                  | 9.67   | \$ | -                               |
| Granted   | -         |    | -                                     | -  |    | -                               |
| Exercised   | -         |    | -                                     | -  |    | -                               |
| Forfeited   | (362,400) | \$ | 0.23                                  | 8.90   |    | -                               |
| Outstanding at December 31, 2009                    | 2,036,000 | \$ | 0.23                                  | 8.67   | \$ | -                               |
| Granted   | -         |    | -                                     | -  |    | -                               |
| Exercised   | -         |    | -                                     | -  |    | -                               |
| Forfeited   | (74,600)  |    | 0.23                                  | 8.56   |    | -                               |
| Outstanding at December 31, 2010                    | 1,961,400 | \$ | 0.23                                  | 7.67   | \$ | -                               |
| Vested and expected to vest<br>at December 31, 2010 | 1,369,560 | \$ | 0.23                                  | 7.67   | \$ | -                               |
| Exercisable at December 31, 2010                    | 784,560   | \$ | 0.23                                  | 7.67   | \$ | -                               |

The aggregate intrinsic value in the table above is before applicable income taxes and represents the closing stock price as of the reporting dates less the exercise price, multiplied by the number of options that have an exercise price that is less than the closing stock price.

As of December 31, 2010, there were 585,000 unvested options and total unrecognized stock-based compensation expense related to these options of approximately \$73,000, which is expected to be recognized over a weighted average period of approximately 3.5 years.

## 8. LEASE COMMITMENTS

The Company leases some of its warehouse space on a month-to-month basis and has entered into an operating lease for the rental of office and warehouse space which expires in August 2012. The following table shows the aggregate minimum annual rental commitments for operating leases having initial or remaining non-cancelable lease terms in excess of one year for the years ending December 31.

|                |    |     |
|----------------|----|-----|
| (In thousands) |    |     |
| 2011           | \$ | 98  |
| 2012           |    | 66  |
|                |    | 164 |
|                | \$ | 164 |

Rent expense for the years ended December 31, 2010 and 2009 was approximately \$243,000 and \$209,000, respectively. Upon the completion of the sale of the Reconstructive Division under the Asset Purchase Agreement, the above lease will be assigned to Arthrex.

## 9. SEGMENT INFORMATION

The Company's businesses are currently organized into the following two reportable segments; reconstructive products (the "Reconstructive Division") and spine products (the "Spine Division"). The Reconstructive Division segment is comprised of activity relating to the Company's unicompartmental knee, patellofemoral products, the total knee and hip products. The Spine Division segment is comprised of the spinal lumbar fusion system and cervical plate and screw systems.

The division into these reportable segments is based on the nature of the products offered. Management evaluates performance and allocates resources based on several factors, of which the primary financial measure is segment operating results. Due to the distinct nature of the products in the Company's Reconstructive Division, and the fact that it has a more developed market for its products, it is considered by management as a separate segment. The Company's Spine Division is still in the process of developing the market and obtaining instrumentation necessary to sell the products in greater quantities. As a result of the unique characteristics of this product line, the Spine Division is considered by management as a separate segment.

As described in Note 1, on October 7, 2010, the Company's management and Board of Directors decided to put substantially all of its assets up for sale, consisting of the inventories, intellectual property, and property and equipment of the Reconstructive Division and the Spine Division. As a result, all of the inventory and property and equipment associated with these divisions has been classified as assets held for sale.

As of December 31, 2009, the Company's Reconstructive Division includes \$1,233,000 of goodwill and \$4,353,000 in other intangible assets relating to the Company's uni compartmental knee product. During the year ended December 31, 2010, these amounts were determined to be impaired. As a result, a total impairment charge of \$5,283,000 was recorded and allocated to the Reconstructive Division.

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The following table sets forth financial information by reportable segment. The Company's adjustments relating to its discontinued operations are reflected below. The information from 2009 has been reclassified to conform with the current year presentation.

| (In thousands)                             | <u>Reconstructive<br/>Division</u> | <u>Spine<br/>Division</u> | <u>Corporate</u>  | <u>Discontinued<br/>Operations</u> | <u>Total</u>       |
|--|------------------------------------|---------------------------|-------------------|------------------------------------|--------------------|
| <b>Year Ended December 31, 2010</b>        |                                    |                           |                   |                                    |                    |
| Net sales                                  | \$ 2,208                           | \$ 1,104                  | \$ -              | \$ (3,312)                         | \$ -               |
| Total cost of sales and operating expenses | 6,310                              | 1,297                     | 6,274             | (13,298)                           | 583                |
| Depreciation and amortization              | 916                                | 10                        | 41                | (967)                              | -                  |
| Interest income, net                       | -                                  | -                         | 27                | -                                  | 27                 |
| Provision for income taxes                 | -                                  | -                         | -                 | -                                  | -                  |
| Loss from discontinued operations          | -                                  | -                         | -                 | (10,953)                           | (10,953)           |
| <b>Net income (loss)</b>                   | <b>\$ (5,018)</b>                  | <b>\$ (203)</b>           | <b>\$ (6,288)</b> | <b>\$ -</b>                        | <b>\$ (11,509)</b> |
| Property and equipment acquisitions        | \$ 806                             | \$ 134                    | \$ 129            | \$ -                               | \$ 1,069           |
| Goodwill                                   | -                                  | -                         | -                 | -                                  | -                  |
| Total assets                               | \$ 4,212                           | \$ 750                    | \$ 473            | \$ -                               | \$ 5,435           |
| <b>Year Ended December 31, 2009</b>        |                                    |                           |                   |                                    |                    |
| Net sales                                  | \$ 1,540                           | \$ 329                    | \$ -              | \$ (1,869)                         | \$ -               |
| Total cost of sales and operating expenses | 326                                | 54                        | 5,384             | (5,214)                            | 550                |
| Depreciation and amortization              | 1,164                              | 7                         | 36                | (1,207)                            | -                  |
| Interest expense, net                      | -                                  | -                         | 24                | -                                  | 24                 |
| Loss from discontinued operations          | -                                  | -                         | -                 | (4,552)                            | (4,552)            |
| <b>Net income (loss)</b>                   | <b>\$ 50</b>                       | <b>\$ 268</b>             | <b>\$ (5,396)</b> | <b>\$ -</b>                        | <b>\$ (5,078)</b>  |
| Property and equipment acquisitions        | \$ 932                             | \$ 14                     | \$ 72             | \$ -                               | \$ 1,018           |
| Goodwill                                   | 1,233                              | -                         | -                 | (1,233)                            | -                  |
| Total assets                               | \$ 8,815                           | \$ 1,574                  | \$ 5,199          | \$ -                               | \$ 15,588          |

All of the Company's net sales were attributable to activity in the United States. There were no long-lived assets held in foreign countries.

## 10. SUBSEQUENT EVENTS

On January 24, 2011, the Company entered into an Asset Purchase Agreement with Arthrex, Inc. ("Arthrex"), pursuant to which the Company has agreed to sell the assets of the Reconstructive Division, to Arthrex in exchange for cash consideration of approximately \$9.9 million, plus the value of the Company's inventory and property and equipment relating to the Reconstructive Division calculated as of the closing date. The Asset Purchase Agreement also calls for the Company to receive royalty payments equal to 5% of net sales of the Company's products made by Arthrex on a quarterly basis for a term up to and including the 20th anniversary of the closing date. Following the execution of the Asset Purchase Agreement, Arthrex delivered to the Company a \$250,000 deposit to be credited against the cash consideration due at closing. From the cash consideration paid at closing, \$900,000 will be deposited with an escrow agent for a period of twelve months from the closing date to be used for any adjustments to the value of the Company's inventory and property, plant and equipment relating to the Reconstructive Division and for post closing indemnification claims which may be asserted by Arthrex with respect to unassumed liabilities. Cardo estimates that the value of their inventory and property, plant and equipment relating to the Reconstructive Division as of the closing date will be approximately \$4.7 million. The Asset Purchase Agreement calls for the transaction to be completed by April 24, 2011 (the "End Date"). If the transaction is not completed by the End Date, Arthrex, under certain circumstances, can terminate the Asset Purchase Agreement



On March 18, 2011, the Company entered into the First Amendment to the Asset Purchase Agreement, dated as of January 24, 2011, with Arthrex. The first amendment modifies the definition of "End Date" so that it means May 24, 2011; provided that if (i) the closing has not occurred by reason of the failure to satisfy the condition in the Asset Purchase Agreement that at least 20 calendar days have passed since an Information Statement has been filed with the SEC and transmitted to every record holder of shares of the Company, but (ii) the SEC has cleared the Company's responses to the SEC's comment letter and no unresolved comments are pending before the SEC with respect to the Information Statement on or before such date, then the End Date shall be June 24, 2011. Pursuant to the terms of the Asset Purchase Agreement, Arthrex can terminate the Asset Purchase Agreement if certain conditions have not been fulfilled or waived by the End Date.

On March 18, 2011, the Company and Arthrex executed a Secured Promissory Note in favor of Arthrex (the "Arthrex Note"). Under the terms of the Arthrex Note, the \$250,000 deposit made by Arthrex on January 24, 2011 pursuant to the terms of the Asset Purchase Agreement constitutes an initial loan. Under the terms of the Arthrex Note, Arthrex will (a) make a second loan to the Company of such amount to repay the indebtedness owed to Jon Brooks in the principal amount of \$300,000 plus all accrued and unpaid interest thereon (the "Brooks Note ") and the indebtedness owed to Earl Brien, M.D. in the principal amount of \$200,000 plus all accrued and unpaid interest thereon (the "Brien Note"), and (b) make additional advances within two business days of the written request of the Company; provided that in no event shall the aggregate principal amount loaned under the Arthrex Note at any time exceed \$1,250,000. Pursuant to the Arthrex Note, the Company promises to repay to Arthrex the principal amount outstanding from time to time on the Arthrex Note together with all accrued and unpaid interest on the maturity date. The maturity date shall mean the earlier of: (i) the closing of the transactions contemplated by the Asset Purchase Agreement, (ii) the fifth day following the termination of the Asset Purchase Agreement pursuant to its terms, and (iii) the End Date (as defined in the Asset Purchase Agreement). Interest on the unpaid principal amount due under the Arthrex Note accrues at an interest rate of 6% per annum; provided that if an event of default occurs, interest on the unpaid principal amount due under the Arthrex Note shall increase to an interest rate of 12% per annum.

The proceeds obtained by the Company under the Arthrex Note were used to pay off the Brooks Note and the Brien Note and satisfy all obligations under the Brooks Note and the Brien Note and the security agreements relating to such indebtedness totaling \$522,000 on March 18, 2011 (see Note 3). The outstanding borrowing from Jon Brooks was reflected as "note payable - related party" on the accompanying consolidated balance sheet as of December 31, 2010. Proceeds obtained from additional drawdowns on the Arthrex Note can be used for ordinary course working capital needs of the Company's Reconstructive Division. In March 2011, the Company made additional drawdowns of \$450,000 under the Arthrex Note.

Pursuant to the Arthrex Note, the Company granted, pledged and assigned to Arthrex a security interest in all assets (including the acquired assets as defined in the Asset Purchase Agreement), goods, inventories, properties and business of the Company, either tangible, intangible, real, personal, mixed, together with all proceeds or products thereof including, without limitation, all leasehold interests, all payments under insurance, or any indemnity, warranty or guaranty, which security interest shall rank senior to and have priority over those held by all other creditors of the Company.

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

None.

CONTROLS AND PROCEDURES

Item 9A. Controls and Procedures

Disclosure Controls and Procedures

We maintain disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act, that are designed to ensure that information required to be disclosed in our reports under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms, and that such information is accumulated and communicated to our management, including our principal executive officer and our principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

We carried out an evaluation under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this Annual Report. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of December 31, 2010.

Internal Control Over Financial Reporting

Our internal control over financial reporting is 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. Our internal control over financial reporting includes those policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our 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.

Changes in Internal Control Over Financial Reporting

There was no change to the Company's internal control over financial reporting during the quarter ended December 31, 2010 that materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Management's Report on Internal Control Over Financial Reporting

Under the direction of our Chief Executive Officer and Chief Financial Officer, management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) and 15d-15(f) under the Exchange Act). Management evaluated the effectiveness of our internal control over financial reporting as of December 31, 2010 based upon the control criteria established in a report entitled *Internal Control* —

*Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Our internal control over financial reporting was deemed effective as of December 31, 2010.

This annual report does not include an attestation report of our independent registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by our independent registered public accounting firm pursuant to the Dodd-Frank Act that permanently exempted non-accelerated filers from the auditor attestation requirement.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance.

The information required by this Item is incorporated by reference to the definitive proxy statement for our 2011 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission within 120 days of December 31, 2010.

Item 11. Executive Compensation.

The information required by this Item is incorporated by reference to the definitive proxy statement for our 2011 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission within 120 days of December 31, 2010.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The information required by this Item is incorporated by reference to the definitive proxy statement for our 2011 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission within 120 days of December 31, 2010.

Item 13. Certain Relationships and Related Transactions, and Director Independence.

The information required by this Item is incorporated by reference to the definitive proxy statement for our 2011 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission within 120 days of December 31, 2010.

Item 14. Principal Accounting Fees and Services.

The information required by this Item is incorporated by reference to the definitive proxy statement for our 2011 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission within 120 days of December 31, 2010.

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a)(1) The following consolidated financial statements of Cardo Medical, Inc. are incorporated by reference in Part II:

Management's Report on Internal Control over Financial Reporting  
Report of Independent Registered Accounting Firm  
Consolidated Balance Sheets  
Consolidated Statement of Operations

Consolidated Statements of Stockholders' Equity  
Consolidated Statements of Cash Flows  
Notes to Consolidated Financial Statements

(a)(2) Financial Statement Schedules

All schedules have been omitted because they are inapplicable or the information is provided in the consolidated financial statements including the notes hereto.

(a)(3) Exhibits Required by Item 601 of Regulation S-K:

INDEX TO EXHIBITS

| Exhibit<br>Number | Description  |
|-------------------|--|
|                   | 2.1 <sup>(1)</sup>   |
|                   | Merger Agreement and Plan of Reorganization, dated as of June 18, 2008, by and among clickNsettle.com, Inc., Cardo Medical, LLC and Cardo Acquisition, LLC.                      |
|                   | 2.2 <sup>†</sup>   |
|                   | First Amendment to Merger Agreement and Plan of Reorganization, dated as of August 29, 2008, by and among clickNsettle.com, Inc., Cardo Medical, LLC and Cardo Acquisition, LLC. |
|                   | 2.3 <sup>(7)</sup>   |
|                   | Asset Purchase Agreement, dated September 30, 2009, by and among Cardo Medical, Inc. and Vertebron, Inc.   |
|                   | 2.4 <sup>(9)</sup>   |
|                   | Asset Purchase Agreement, dated January 24, 2011, by and among Cardo Medical, Inc., Cardo Medical, LLC and Arthrex, Inc.   |
|                   | 2.5 <sup>(10)</sup>  |
|                   | First Amendment to Asset Purchase Agreement, effective March 18, 2011, by and among Cardo Medical, Inc., Cardo Medical, LLC and Arthrex, Inc.                                    |
|                   | 3.1 <sup>(2)</sup>   |
|                   | Amended and Restated Certificate of Incorporation.   |
|                   | 3.2 <sup>(3)</sup>   |
|                   | Amended and Restated Bylaws.   |

3.3<sup>(11)</sup>

Certificate of Amendment of Amended and Restated Certificate of Incorporation of clickNsettle.com, Inc.

10.1†

Escrow Agreement, dated as of August 29, 2008, by and among Chicago Title Company, clickNsettle.com, Inc., Andrew A. Brooks, M.D. and Mikhail Kvitnitsky.

10.2†

Form of Lockup Agreement.

10.3†

Lockup Agreement, dated August 29, 2008, for Derrick Romine.

10.4<sup>(4)</sup>

Amended and Restated 1996 Incentive and Nonqualified Stock Option Plan.

10.5†\*

Form of Cardo Medical, LLC Nonstatutory Option Agreement.

10.6<sup>(5)</sup>

Stock Purchase Agreement, dated as of December 19, 2007, by and among clickNsettle.com, Inc., Frost Gamma Investments Trust, Dr. Jane Hsiao, Steven D. Rubin and Subbarao Uppaluri.

10.7<sup>(3)</sup>

First Amendment to Stock Purchase Agreement, dated as of January 31, 2008, by and among clickNsettle.com, Inc., Frost Gamma Investments Trust, Dr. Jane Hsiao, Steven D. Rubin and Subbarao Uppaluri.

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- 10.8†\* Employment Agreement, dated as of January 31, 2005, by and between Accelerated Innovation, LLC, as successor to Accin Corporation, and Mikhail Kvitnitsky.
- 10.9†\* Amendment to Employment Agreement, dated as of June 6, 2008, by and between Accelerated Innovation, LLC and Mikhail Kvitnitsky.
- 10.10†\* Termination Agreement, effective as of June 23, 2008, by and between Accelerated Innovation, LLC and Mikhail Kvitnitsky.
- 10.11†\* Employment Offer Letter with Derrick Romine dated September 5, 2008.
- 10.12† Form of Indemnification Agreement for officers and directors.
- 10.13†‡ Agreement, dated as of August 22, 2006, by and between Accelerated Innovation, LLC, as successor to Accin Corporation, and Infinesse Corporation.
- 10.14† Supplier Agreement, dated June 16, 2006, between Stelkast Company and Accelerated Innovation, LLC, as successor to Accin.
- 10.15†‡ Contracted Services Agreement, dated September 1, 2007, by and between Accelerated Innovation, LLC and Summit Corporate Services, Inc.
- 10.16† Agreement dated April 30, 2008, by and among Mikhail Kvitnitsky and Accelerated Innovation, LLC, Cervical Xpand, LLC and Uni-Knee, LLC.
- 10.17† Agreement dated April 30, 2008, by and among John D. Kuczynski, Accelerated Innovation, LLC and Uni-Knee, LLC.
- 10.18† Agreement dated April 30, 2008, by and among Richard H. Rothman, M.D., Ph.D., Accelerated Innovation, LLC and Cervical Xpand, LLC.
- 10.19† Agreement dated April 30, 2008, by and among Todd J. Albert, M.D., Accelerated Innovation, LLC and Cervical Xpand, LLC.
- 10.20† Agreement dated April 28, 2008, by and among, Rafail Zubok, Accelerated Innovation, LLC and Cervical Xpand, LLC.
- 10.21<sup>(6)</sup>\* Nonstatutory Option Agreement, dated August 27, 2008, by and between Cardo Medical, LLC and Derrick Romine.
- 10.22<sup>(8)</sup> Form of Registration Rights Agreement, dated October 27, 2009, by and among Cardo Medical, Inc. and the several purchasers signatory thereto.
- 10.23<sup>(12)</sup> Cardo Medical, Inc. 2010 Equity Incentive Plan
- 10.24<sup>(13)</sup> Secured Promissory Note by the Company in Favor of Jon Brooks, dated November 2, 2010.
- 10.25<sup>(13)</sup> Security Agreement between the Company and Jon Brooks, dated November 2, 2010.
- 10.26<sup>(13)</sup> Secured Promissory Note by the Company in Favor of Earl Brien, dated November 4, 2010.
- 10.27<sup>(13)</sup> Security Agreement between the Company and Earl Brien, dated November 4, 2010.
- 10.28<sup>(10)</sup> Secured Promissory Note by Cardo Medical, Inc. and Cardo Medical, LLC in favor of Arthrex, Inc. dated March 18, 2011.
- 21.1† Subsidiaries of Cardo Medical, Inc.

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- 31.1# Certification of Chief Executive Officer
- 31.2# Certification of Chief Financial Officer
- 32.1# Certification of Chief Executive Officer Pursuant to Rule 13a-14(b) and Section 906 of the Sarbanes-Oxley Act of 2002 (Subsections (a) and (b) of Section 1350, Title 18, United States Code)
- 32.2# Certification of Chief Financial Officer Pursuant to Rule 13a-14(b) and Section 906 of the Sarbanes-Oxley Act of 2002 (Subsections (a) and (b) of Section 1350, Title 18, United States Code)

#

Filed herewith.

†

Previously filed as an exhibit to the Current Report on Form 8-K filed by us on September 9, 2008.

‡

Confidential treatment has been requested as to a portion of this exhibit. The confidential portion of this exhibit has been omitted and filed separately with the Securities and Exchange Commission.

\*

Management compensation plan or agreement.

(1)

Previously filed as an exhibit to the Current Report on Form 8-K filed by us on June 23, 2008.

(2)

Previously filed as an exhibit to the Current Report on Form 8-K filed by us on March 18, 2008.

(3)

Previously filed as an exhibit to the Current Report on Form 8-K filed by us on February 1, 2008.

(4)

Previously filed as an exhibit to the Annual Report on Form 10-KSB filed by us on September 28, 1998.

(5)

Previously filed as an exhibit to the Current Report on Form 8-K filed by us on December 21, 2007.

(6)

Previously filed as an exhibit to the Quarterly Report on Form 10-Q filed by us on November 14, 2008.

(7)

Previously filed as an exhibit to the Current Report on Form 8-K filed by us on October 6, 2009.

(8)

Previously filed as an exhibit to the Current Report on Form 8-K filed by us on October 29, 2009.

(9)

Previously filed as an exhibit to the Current Report on Form 8-K filed by us on January 27, 2011.

(10)

Previously filed as an exhibit to the Current Report on Form 8-K filed by us on March 24, 2011.

(11)

Previously filed as an Annex to the Information Statement on Schedule 14C filed by us on September 30, 2008.

(12)

Previously filed as an exhibit to the Quarterly Report on Form 10-Q filed by us on August 12, 2010.

(13)

Previously filed as an exhibit to the Current Report on Form 8-K filed by us on November 8, 2010.

(14)

Previously filed as an exhibit to the Amendment to the Current Report on Form 8-K/A filed by us on November 3, 2010.

(15)

Previously filed as an exhibit to the Current Report on Form 8-K filed by us on August 12, 2010.

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## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

## CARDO MEDICAL, INC.

/s/ Andrew A. Brooks

Dated:

March 31, 2011

Andrew A. Brooks

Chief Executive Officer

Pursuant to the requirements of the Securities and Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| Signature                     | Title  | Date           |
|-------------------------------|--|----------------|
| <u>/s/ Andrew A. Brooks</u>   | Chairman of the Board and Chief Executive Officer<br>(Principal Executive Officer) | March 31, 2011 |
| Andrew A. Brooks              |  |                |
| <u>/s/ Derrick Romine</u>     | Chief Financial Officer<br>(Principal Financial and Accounting Officer)            | March 31, 2011 |
| Derrick Romine                |  |                |
| <u>/s/ Michael Kvitnitsky</u> | President, Chief Operating Officer and Director                                    | March 31, 2011 |
| Michael Kvitnitsky            |  |                |
| <u>/s/ Stephen Liu</u>        | Director   | March 31, 2011 |
| Stephen Liu                   |  |                |
| <u>/s/ Thomas H. Morgan</u>   | Director   | March 31, 2011 |
| Thomas H. Morgan              |  |                |
| <u>/s/ Ronald N. Richards</u> | Director   | March 31, 2011 |
| Ronald N. Richards            |  |                |
| <u>/s/ Steven D. Rubin</u>    | Director   | March 31, 2011 |

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Steven D. Rubin

/s/ Subbarao Uppaluri

Director

March 31, 2011

Subbarao Uppaluri