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GMED - Q2 2017 Globus Medical Inc Earnings Call

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AUGUST 02, 2017 / 9:30PM, GMED - Q2 2017 Globus Medical Inc Earnings Call

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**David C. Paul** *Globus Medical, Inc. - Co-Founder, Chairman and CEO*

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## PRESENTATION

### Operator

Hello. My name is Jason, and I will be your conference operator today.

At this time, I would like to welcome everyone to the Globus Medical Second Quarter 2017 Earnings Release Conference Call. (Operator Instructions)

I would now like to turn the call over to our host, Mr. Brian Kearns, Vice President of Business Development and Investor Relations. Sir, you may begin your conference.

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### Brian Kearns

Thank you, Jason, and thank you, everyone, for being with us today.

Joining today's call from Globus Medical will be David Paul, Chairman and CEO; Dan Scavilla, Senior Vice President and CFO; Anthony Williams, President; and Dave Demski, Group President of Emerging Technologies.

This review is being made available via webcast accessible through the Investor Relations section of the Globus Medical website at [www.globusmedical.com](http://www.globusmedical.com).

Before we begin, let me remind you that some of the statements made during this review are or may be considered forward-looking statements. Our Form 10-K for the 2016 fiscal year and our subsequent filings with the Securities and Exchange Commission identify certain factors that could cause our actual results to differ materially from those projected in any forward-looking statements made today. Our SEC filings, including the 10-K, are available on our website.

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We do not undertake to update any forward-looking statements as a result of new information or future events or developments. Our discussion today will also include certain financial measures that are not calculated in accordance with generally accepted accounting principles, or GAAP. We believe these non-GAAP financial measures provide additional information pertinent to our business performance. These non-GAAP financial measures should not be considered replacements for, and should be read together with, the most directly comparable GAAP financial measures. Reconciliations to the most directly comparable GAAP measures are available in the schedules accompanying the press release and on the Investor Relations section of the Globus Medical website.

With that, I'll now turn the call over to David Paul, our Chairman and CEO.

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**David C. Paul** - *Globus Medical, Inc. - Co-Founder, Chairman and CEO*

Thank you, Brian, and good evening, everyone.

Worldwide sales for the second quarter of 2017 were \$152.4 million, an increase of 10.8% as reported, and 11% in constant currency over the second quarter of 2016.

In the second quarter, we generated non-GAAP diluted EPS of \$0.32 and an industry-leading 35.1% in adjusted EBITDA. The strong second quarter results on the heels of our last 2 quarters further indicate that we have passed the inflection point in returning to higher growth rates in our core U.S. spinal implant business by year-end.

Our team is very pleased with our performance during the second quarter. We had a strong competitive rep hiring quarter, further expanded our in-house manufacturing capacity and, last but not least, continued to run an extremely efficient organization with best-in-class EBITDA margins.

Efforts to improve sales force expansion and productivity are beginning to bear fruit. With progress in our sales force and the upcoming launches of robotics and trauma products, we remain very excited about our future.

On today's call, I would like to update you on several areas: efforts to rekindle sales expansion in the U.S., the Alphatec International integration, the acquisition of KB Medical and progress on Emerging Technologies.

Sales force expansion. As noted in our previous calls, we have been working to resolve issues with the pace and productivity of our U.S. sales force expansion efforts. The 3 areas of focus are improving recruitment, new territory development and retention.

On the recruitment front, I'm happy to report that through the first half of 2017, we have hired more competitive reps than in any full year in our history. The continued focus of our field sales management team, along with our efforts to be more aggressive in hiring competitive reps, has not only produced record results to date, but we have a full pipeline of potential recruits for the second half of this year. Our best-in-class product portfolio and robust product pipeline continues to make Globus the destination of choice for the best sales talent in our industry.

On the development front, our sales management team has instituted a comprehensive recruiting and development program to groom high-potential individuals without prior signs -- spine sales experience into highly productive straight-commission sales reps within 3 years of hire. This program was begun in earnest in 2016, with the first recruits taking on their own territories in Q2 of this year. While this is a longer-term model from recruitment to straight commission, we believe that investing in this area will provide an important capability for long-term sales force expansion.

Turning to attrition. We believe the steps we have taken to address operational issues and minimize attrition have been successful. And we are no longer seeing the increased level of turnover among productive reps that we experienced in the first half of 2016. We remain diligent in this area and are proactively addressing any issues that may arise on a day-to-day basis. We are confident that all of these efforts position us on a path of sustained, meaningful territory expansion, leading to increasing sales growth rates over the next several years.

Turning to international sales efforts. International sales grew by 104.5%, including the acquisition of the Alphatec International business, which added approximately \$15.5 million of sales in the second quarter of 2017. We are pleased with the continued integration of the Alphatec distributor



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network into ours. We have made significant progress with regulatory submissions in Japan and are pleased to announce that several Globus products have been approved by the PMDA, and we look forward to fully introducing the systems in the second half of 2017.

The first Globus surgery in Japan was performed last week using the CREO Threaded system, and sets continue to roll out as the business transitions from Alphatec products to Globus products.

Simultaneously, we are investing in several new sales territories in Japan to expand our sales force in this previously under-invested market. Further investment in sets and replenishment inventory are anticipated as we transition the entire customer base to Globus products.

Our core international sales were soft for the quarter. There were 3 primary drivers: first, our senior international team has been focused on the Alphatec integration. Globus is a lean organization, and the Alphatec acquisition doubled our international sales and footprint overnight. This effort has resulted in a successful acquisition, but it did cost us some focus on our core business.

Second, we have elected to go with former Alphatec distributors in certain markets where they were stronger, which resulted in the loss of core business.

Third, we are in a rebuilding phase with our leadership teams for certain key countries that we have identified previously. With a large portion of the integration effort behind us, we plan to devote more focus and resources towards international growth in the second half of 2017.

As we approach the anniversary of the Alphatec acquisition, our international business is much stronger than it was one year ago. The overall scale and profitability of the segment are much improved. We have significant market share in Japan and other important markets, and we are positioned for strong growth in the future. The acquisition demonstrates our ability and commitment to using our balance sheet to expand our business profitably in key strategic areas.

Emerging Technologies. On the Excelsius GPS system, we continue to make steady progress in preparation for worldwide launch, including logistics, supply chain, manufacturing and support.

In the U.S., we resubmitted to the FDA in June and expect to gain 510(k) clearance in the near future. The capital sales force has been hired, trained and is ready to help Globus enter this nascent but potentially large market.

Excelsius GPS is the only product designed to work with 3 different imaging modalities, with optimized workflow for the operating room surgeon and staff, and fully integrates with our implant technologies. Our belief in the tremendous potential of this game-changing technology to improve patient outcomes and safety has led us to increase investments in R&D, technology acquisition and distribution channels.

In that vein, this evening, we announced the acquisition of KB Medical, an innovative robotics company out of Switzerland. This acquisition significantly bolsters our development team, intellectual property and product portfolio. KB Medical has a tremendous team of innovative developers that share our philosophy, approach and strategy for robotic solutions in medicine.

On the trauma side, we have received FDA clearance and are in full production mode for several products that are planned for launch by the end of this year. We have begun building out the commercial organization and will accelerate this effort throughout the year. These emerging technology opportunities will enable us to further strengthen our business and create a larger footprint within customer hospitals and institutions, while contributing to increasing sales growth rates over the next few years, all in support of our drive to reach \$1 billion in sales.

As we have demonstrated, our balance sheet will continue to be used as a tool to add technologies and businesses that will lead to profitable growth. Ongoing innovative product launches in spine have been the lifeblood of our growth since inception. We intend to continue this trend in the second half of 2017 as several new products are on deck for launch throughout the end of the year.

In summary, as we invest and build towards our long-term goal of creating a diversified musculoskeletal growth company, we remain highly focused on the opportunity to grow our spine business worldwide. I have never been more excited about our prospects as we continue to execute on a



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disciplined growth strategy of rapid new product introductions and worldwide sales force expansion, while maintaining focus on profitability and cash flow.

Over the remainder of the year, we are looking forward to seeing further progress in accelerating U.S. sales force expansion, launching innovative new spine products, completing the integration of the Alphatec International business and taking our first steps into the robotics and trauma markets.

I will now turn the call over to Dan.

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**Daniel T. Scavilla** - *Globus Medical, Inc. - CFO and SVP*

Thanks, David, and good evening, everyone.

We are pleased with the strong financial results in Q2, the continued improvements in the U.S. business performance driven by record recruiting and the progress of our Emerging Tech opportunities in robotics and trauma, both on the cusp of commercialization.

For Q2, sales were \$152.4 million, growing 10.8% as reported or 11% in constant currency with GAAP net income of \$28.7 million and non-GAAP net income of \$30.8 million, delivering \$0.32 fully diluted non-GAAP earnings per share and 35.1% adjusted EBITDA.

Focusing on sales, U.S. sales for the quarter were \$126.3 million, 1.2% higher than Q2 '16, or 3% higher when adjusted for 1 less day in Q2 '17. We continue to see growth acceleration and sequential improvements in the U.S. business, with year-over-year organic growth rates improving from negative 4.1% in Q3 '16 to positive 3% in Q2 '17 on a day-adjusted basis. This is driven by stronger competitive rep recruiting and other structural improvements we have made to the business that we believe will drive continued momentum and quarterly improvements to revenue throughout the year.

International sales for the quarter were \$26.1 million, growing 104.5% as reported, or 106.6% in constant currency, driven by the acquired Alphatec business, which contributed \$15.5 million for the quarter.

Q2 '17 will be the last quarter we highlight the performance of the Alphatec business separately from international core, as we believe the consolidated results better represent our overall international performance.

For example, in Q2, we had several million dollars of distributor sales cross-channel from Globus into Alphatec distributors, somewhat distorting the performance of each area.

We've also begun selling Globus products in several Alphatec direct markets, cannibalizing existing Alphatec volumes as well as expanding into new customers. With these reasons in mind and as we reach the anniversary of the acquisition in Q3, we plan to report one international sales figure going forward.

We remain pleased with the top line and the bottom line contribution of this successful acquisition and continue to develop its strategic value for international market penetration.

Disruptive Technology sales for the quarter increased to \$72.5 million, or 6.6% growth, with continued strength in our expandable technologies, integrated spacers, CREO MIS and biologics. Innovative Fusion sales for Q2 were \$79.9 million, or 15% growth, driven by international business, cortex and CREO.

Turning to the rest of the P&L. Q2 gross profit was 75.6% compared to 76.2% in Q2 '16 and 77.2% in Q1 '17. The changes versus prior year are driven by the inclusion of the Alphatec business not present in Q2 '16, resulting in a planned, 130 basis point negative mix, partially offset by continued gains from in-house manufacturing, which contributed \$2.2 million in the quarter.



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While the Alphatec product line has a negative GP mix impact, it is accretive in sales, earnings and cash flow. As stated in our Q1 earnings call, Q1 '17 GP included a one-time 120 basis point gain for vendor refunds. The full year gross profit projection remains strong at 76%, incorporating the full year effect of price pressure, biologics and Alphatec product mix.

Research and development expenses for the second quarter were \$10.7 million, or 7% of sales, compared to 7.7% in Q2 '16, reflecting an increase in investments for robotics and trauma, partially offset by timing within core spine.

SG&A expenses for the second quarter were \$64.4 million, or 42.3%, compared to 38.8% in Q2 '16. The increase is primarily driven by the inclusion of Alphatec International cost and the pre-revenue robotic commercial organization build that were not present in Q2 '16, combined with increased investments in the U.S. sales force and physician training.

The income tax rate for Q2 was 27.5% versus 32.7% in Q2 '16. The change in the effective tax rate is driven by 2 main factors: first, there was a one-time gain, driven by foreign tax credits from prior periods; and second, there was an ongoing benefit for the adoption of ASU 2016-09 for stock comp accounting that began in Q1 '17. We're projecting 31% for full year 2017 effective tax rate.

GAAP second quarter net income was \$28.7 million, and GAAP diluted earnings per share were \$0.29. Non-GAAP net income was \$30.8 million, and non-GAAP diluted earnings per share were \$0.32. Investments in Emerging Technologies negatively impacted Q2 '17 EPS by approximately \$0.04.

We ended the quarter with \$373.1 million of cash, cash equivalents and marketable securities. Net cash provided by operating activities in Q2 was \$26 million, and free cash flow was \$12.4 million. Q2 cash flow is typically lower than other quarters of the year, driven by 2 planned tax payments. In Q2, we made \$32.8 million of tax payments in the quarter. The company remains debt-free.

The company reaffirms guidance for full year 2017 sales of approximately \$625 million and non-GAAP diluted earnings per share of \$1.27.

We will now open the call for questions.

## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) And your first question comes from the line of Matthew O'Brien of Piper Jaffray.

### Matthew Oliver O'Brien - Piper Jaffray Companies, Research Division - MD and Senior Research Analyst

Just to start with the Alphatec contribution. Obviously, much higher than expected, again, here this quarter. So the question I have is, should we expect kind of a similar type run rate for that business that we saw last year, which is about \$60 million? And then doesn't that imply still a lot of softness in the domestic business? And I guess, to get to the guidance for the year, that would assume a pretty meaningful pickup. So what gives you the confidence in that latter question really materializing?

### Daniel T. Scavilla - Globus Medical, Inc. - CFO and SVP

Matt, this is Dan. I guess the way I'd go after that is there's many moving parts to Globus as we enter the second half of the year. Look, we've got to consider the continued U.S. recovery due to the ramp-up. And that's going to go to above-market growth, as you said, as it requires continued execution and additional competitive rep conversions. Internationally, we still need to do the ongoing Alphatec integration, which requires execution, while the core international structure needs management focus. The robotic system approval is currently in the FDA's hands, and the



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timing is unknown. So we're managing the business for the long term and as one contiguous unit, not individual parts. We believe the \$625 million sales guidance is realistic. And I'd encourage you not to get ahead of that with so many variables in play for the remainder of the year.

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**Matthew Oliver O'Brien** - Piper Jaffray Companies, Research Division - MD and Senior Research Analyst

Okay. But specifically on Alphatec, should we assume it's much greater than the \$40 million you've been kind of guiding to for the full year?

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**Daniel T. Scavilla** - Globus Medical, Inc. - CFO and SVP

Yes. I would think the fact that we've entered 2 quarters at \$15 million, it's certainly going to go above the \$40 million. What I'm encouraging you to do is, as we look at the uncertainties of Emerging Tech approvals and continued ramp-ups of U.S., is not to move off the \$625 million, which we feel is the appropriate guidance for the year.

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**Matthew Oliver O'Brien** - Piper Jaffray Companies, Research Division - MD and Senior Research Analyst

Okay. And then as a follow-up, on the expandable side of the business, there's quite a bit of competitive entrance that's been occurring here. And I'd love to hear -- knowing you're not wanting to give too much away as far as what you're doing in that segment of the business, but you're the clear industry leader. So is this a 10% to 20% kind of, of your business type range in terms of revenue that you generate from expandables? And then how are you positioned to defend yourself as more people come into the space?

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**David C. Paul** - Globus Medical, Inc. - Co-Founder, Chairman and CEO

Well, your projections are approximately in the right direction, Matt. This is David. As far as protection, I think there's 2 ways that we are protecting ourselves. One is, we're already on the third generation of our expandable technology, and we continue to work on improving the technology even beyond that. So we have multiple projects in place right now where we're working on making more innovations in that space. Secondly, we've built out a very strong IP portfolio. And that's something that we will vigorously enforce going forward because we believe we have a lot of IP in this space. And as I mentioned even in the last quarter call, we continue to expand our IP portfolio in this space.

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**Operator**

Your next question comes from Matt Miksic from UBS.

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**Matthew Stephan Miksic** - UBS Investment Bank, Research Division - Executive Director and Senior Research Analyst

So I guess the first question I'd ask is maybe one that we get a lot from investors. Anything you can do to elaborate on what you're seeing in the marketplace, just around the tone in the U.S.? I don't think it's news. You've heard it on other calls. There seem to be some building consensus that there is some difference or change or a little bit of a headwind maybe on the payer or pre-authorization side. Any color that you've seen that can help sort of confirm that or provide any color would be helpful.

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**David C. Paul** - Globus Medical, Inc. - Co-Founder, Chairman and CEO

Thank you, Matt. This is David. To date, we haven't seen any specific payer pushback from our feedback with our customers. But we are privy to what we are hearing in the marketplace from our other competitors. We are closely monitoring the situation. Of course, there have been summer vacations and the like, but that's something you see every year. On specific payer pushback, we haven't seen much of that.



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**Matthew Stephan Miksic** - *UBS Investment Bank, Research Division - Executive Director and Senior Research Analyst*

Okay. So then if that's the case, I guess I would ask, what has been -- what do you feel has been working in sort of the ramp of the sales force? Because I guess sequentially the growth in Q2 looks a lot like the growth in Q1 in the U.S. And I'm just wondering, what, in your view, is giving you the confidence to re-accelerate in the U.S., as per the previous question? And maybe what do you feel like is working? And what's to come?

**David C. Paul** - *Globus Medical, Inc. - Co-Founder, Chairman and CEO*

I think the biggest thing that gives us the confidence is the success we've been having on the competitive rep recruiting side and the progress we've been making with our U.S. sales force expansion efforts. As I mentioned in the prepared remarks, across-the-board in recruiting, developmental hiring and then in also retention, we feel we've improved a lot from last year. We've turned the corner. We're still not at growth rates that we are happy with, but there are a lot of folks sitting out noncompetes that are coming off noncompetes. So we feel pretty good about the business accelerating in the second half of this year.

**Daniel T. Scavilla** - *Globus Medical, Inc. - CFO and SVP*

Matt, I am going to add to that too, because I do believe we're in the range of where we want to be at this point in the year. If you do look for the days -- and we had 1 extra day in Q1, 1 less in Q2. When you adjust for that, U.S. was actually roughly 0% in Q1 and now about 3% or so kind of in Q2. And so I just think it's important also to recognize that it is sequential acceleration as we get into some of the vacation seasons.

**Matthew Stephan Miksic** - *UBS Investment Bank, Research Division - Executive Director and Senior Research Analyst*

That's very helpful. And could I just ask one more on some of the new products that -- I know you don't get into a lot of color, but it's another question that we get is, where are you or your thoughts on 3-D printed? Just because, as Matt mentioned, expandables is a push; 3-D printed products seems like it's a push. Color on your thoughts there would be helpful.

**David C. Paul** - *Globus Medical, Inc. - Co-Founder, Chairman and CEO*

Thank you, Matt. We have been looking at 3-D printing, and we're making some investigation into that space. We're not fully convinced yet on the clinical need and necessity for it. But that's something we've been looking at and monitoring and doing some research work on it. We will be able to have a response sometime next year for this as we get more information, but that's something we've been closely monitoring. Also, we think that the market for interbody cages is moving more towards expandable technology, with everyone trying to get into the expandable technology. With the clear clinical benefits that expandable technology has over static, we feel we're well positioned in the interbody space.

**Operator**

And your next question comes from the line of Craig Bijou of Wells Fargo.

**Craig William Bijou** - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

I have a couple on the robotics platform. Just wanted to understand -- I appreciate that you resubmitted your filing. Just wanted to get your thoughts on when you do -- when you expect clearance of the robot. And then the contribution that you expect in 2017 from the robotic program.

**David M. Demski** - *Globus Medical, Inc. - Director and Group President of Emerging Technologies*

Craig, this is Dave Demski. We resubmitted in the second quarter. And with the 90-day time period that's typical, we expect to get clearance here in the third quarter at some point. Our interaction with the agency has been positive. And I feel like it's been -- we've been tracking towards an





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approval here soon. In terms of the contribution, that's really challenging to predict. It's our first foray into capital. We've got a lot of surgeon interest. As people have seen the system, they're very impressed with the features that it has, and we think it can bring a lot of value to the hospital in terms of improving patient outcomes and actually pulling some business into the hospital. So very positive about that, but the typical capital cycle is long. So given the fact that it's our first foray, we are expecting revenue this year, but it's really hard to put a number on it where we sit here in early August.

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**Craig William Bijou** - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Okay. That's helpful. And just as a follow-up. I wondered if you guys could go into a little more detail about the strategy behind the KB Medical acquisition, how it fits into your robotics platform. And I mean, is there any -- I mean, I'm assuming there's no -- there's not a negative read-through, given the comment -- the positive comments on Excelsius. But just is there any read-through or any other color you can provide on how KB fits into your platform?

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**David M. Demski** - *Globus Medical, Inc. - Director and Group President of Emerging Technologies*

Sure. It has nothing to do with our situation on Excelsius, our immediate situation with the FDA. It's a strategic buy for us. They have a very strong IP portfolio. They have a really strong group of individuals there or technology developers. They also see the issues, the clinical issues and the technical issues in a very similar fashion to our folks. So I think there's going to be some great synergies on the team. That's primarily it. It's a long-term play that just strengthens us, our position, for the long term.

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**Operator**

And your next question comes from Kyle Rose of Canaccord.

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**Kyle William Rose** - *Canaccord Genuity Limited, Research Division - Senior Analyst*

So I wanted to circle back to the core U.S. business here a little bit. You've talked about competitive sales rep hires in a positive manner for, I guess, going on the last 18 months now. I think last year at this point, you talked about hire reps year-to-date in '16 than all of '15 combined, and you just talked about record reps to start the year. So just maybe kind of give us an understanding of where these reps are coming from and how we should expect the productivity of them as they do start to come off noncompetes exiting into the second half of the year. Just kind of help us understand what these reps look like relative to previous hires.

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**David C. Paul** - *Globus Medical, Inc. - Co-Founder, Chairman and CEO*

Thank you for the question, Kyle. Like I've said from the last quarter on, our competitive rep hiring has been picking up steam even in Q1 of this year and more so in Q2. We feel that a lot of the competitive reps we've hired in 2016 are beginning to roll off their noncompetes. So we think that the second half is going to have more of momentum of these reps coming off their noncompetes and us getting more into these competitive accounts. It generally takes 12, and some companies have 18-month noncompetes. So there is a waiting period before we can fully exploit the vacuum that is created. But we've been extremely pleased with the positive impact that these reps are already beginning to have -- our hires in 2017. Like I've said before, our growth is predicated on 2 things: innovative products and then growing our sales force. And while we didn't have a great 2016, it's taken us a while to get that momentum back and change back into that inflection point. And we feel pretty good about how we are going to perform in the second half of this year in the U.S.



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**Daniel T. Scavilla** - *Globus Medical, Inc. - CFO and SVP*

Kyle, one other thing to consider too. And not dissimilar to other quarters, but the recruiting that we do tends to be based on market-appropriate size as well. So you kind of look out who the players are, and it's within that ratio that recruiting normally occurs.

**Kyle William Rose** - *Canaccord Genuity Limited, Research Division - Senior Analyst*

Okay. I appreciate the color. And then the second question, then I'll hop back in queue. Dovetailing off of Matt's question on the expandable cages, I understand you guys are on the gen 3 in the market and the market leaders. So expect you guys to continue in that vein. But when you're seeing these new products launch, I mean, are you seeing any increased pricing pressure or anything along those lines as the new competitors come in and do have to compete against you? And if you're on gen 3 and they're on gen 1, maybe they have to sacrifice a little more price. Are you seeing any increased price pressure year-to-date in '17?

**David C. Paul** - *Globus Medical, Inc. - Co-Founder, Chairman and CEO*

I think it's too early to say. I know we had the same issues when another competitor came out about 2, 3 years ago. There were some initial accounts where we saw some pricing pressure. But once the product differences became starker, once they started using the product, that seemed to dissipate. So it's too early to say with the current crop of expandable cages. I think a couple of companies are in their alpha launch. So we're closely monitoring it. And it's too early to comment on the pricing.

**Operator**

And your next question comes from Jonathan Demchick of Morgan Stanley.

**Jonathan Lee Demchick** - *Morgan Stanley, Research Division - Equity Analyst*

I know a few others have asked, I guess, questions on the competitive recruitment side of things and how successful you've been of late. But given the recent success compared to some challenges with sales force expansion a year ago, what changed in your approach?

**David C. Paul** - *Globus Medical, Inc. - Co-Founder, Chairman and CEO*

I think a lot of discipline amongst our senior leadership team and within the sales management team. We've also been more aggressive in hiring these reps. We have a lot of detailed follow-up. I think, in general, just a lot more focus on developing the sales force with our sales management team. And the monthly review and focus has gone a long way.

**Jonathan Lee Demchick** - *Morgan Stanley, Research Division - Equity Analyst*

Very helpful. And just, I guess, 2 quick follow-ups. One for Dan and one for Dave. So Dan, I was hoping given the -- I guess margins were always kind of a strong point for you all. A little lighter than, I guess, historically for you guys this quarter. Was wondering if you could maybe help us think about the puts and takes into the back half of the year. And then, Dave, on robotics, with kind of taking KB Medical on board, I mean, I assume that the form factor of the robot is going to remain of the Excelsius model and you're not shifting anything around in that sort of stance?

**Daniel T. Scavilla** - *Globus Medical, Inc. - CFO and SVP*

Sure. So Jon, I'll start off with this. I'm pretty pleased where the margins are. As you remember, what we've said publicly is we would go out with a fairly strong Q1. And it's really Q2, Q3 where you're going to see what I consider to be the maximum pressure of the pre-revenue robotics sales force, which we're carrying right now. And as David said, we're beginning to build out the trauma group as well. So this is money well spent for



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the long term where we're focused. There will be some temporary pull downs. And as you get through Q4 and I think with stronger revenues from different sources, you'll come back up to what's normal. So again, exiting a year of heavy investment with an overall average of 36% EBITDA is pretty good. I think the same thing with the GP for the full year of 76. So puts and takes are really just going to be the driver of revenue, the on-boarding of reps driving the revenue, the continued leveraging of other items as we invest appropriately. No real magic. I think we've got a clear pathway how to get there.

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**David M. Demski** - *Globus Medical, Inc. - Director and Group President of Emerging Technologies*

And Jonathan, this is David. In terms of your question on the form factor of Excelsius, you're correct. That's not going to change. So really the KB is going to impact how our next generation will look and how some of our -- the evolution and enhancements of the technology will be rolled out in the next year or 2.

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**Operator**

And your next question comes from Kaila Krum of William Blair.

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**Kaila Paige Krum** - *William Blair & Company L.L.C., Research Division - Research Analyst*

So just a follow-up on KB Medical. So it looks like KB already has a robotic system with clinical trial experience in the U.S. So I guess, can you just talk a little bit about what exactly this company has from a product perspective today? Is there any revenue today with these products? Just trying to better understand, I guess, why add this technology to your portfolio now.

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**David M. Demski** - *Globus Medical, Inc. - Director and Group President of Emerging Technologies*

Kaila, yes. They have a CE-marked product. And they've done clinical trials in Europe with it. They've not done the trials in the U.S. And the product that they have now, we don't intend to market. So it's going to be -- right now, we're evaluating our portfolio and what we want that to look like. So no revenue impact for at least a year, I would say. And just in terms of why, again, it goes back to the development expertise that they have and the IP portfolio they have as well.

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**Kaila Paige Krum** - *William Blair & Company L.L.C., Research Division - Research Analyst*

Okay, okay. That makes sense. And then I guess just on guidance. I guess just with Alphatec performing so much better than expected, and it sounds like you're essentially lifting guidance for that business by, call it, \$10 million, \$20 million compared to prior comments. I guess where should we assume that those revenues are coming from primarily? I mean, should we consider removing all sort of Emerging Technologies contribution for the full year? A bit out of the core business? Just trying to understand how to think about that going forward.

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**Daniel T. Scavilla** - *Globus Medical, Inc. - CFO and SVP*

I appreciate the question, Kaila. A couple of things. Keep in mind one of the statements that I had made is we are seeing a crossover of revenues occur in Alphatec that are coming from Globus. So it's not just pure additive. But when I look at what I consider somewhat of the weaker international, a portion of that -- in fact, a good portion of that is driven by the fact that we're selecting Alphatec folks. So we need to do the balance as a holistic company, not look at those individual parts. I think given that we still have 6 months ahead of us and we need to get the U.S. above market performing growth, and I think that's a challenge we feel comfortable with but nonetheless a risk that's out there. And again, with that uncertainty of Emerging Tech, we certainly do have that in and do intend to have revenues for that. But the exact amount and when is uncertain. So with so many moving parts, so much uncertainty right now, we're just stepping back to say in total, we have many levers that in total, we feel we can



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achieve the \$625 million. Part of that is a little bit of strength that's occurring from the direct markets of Alphatec, and then the others are the uncertainties we still need to work through as a leadership team in the next 6 months.

**Operator**

And your next question comes from Rich Newitter of Leerink.

**Richard S. Newitter** - *Leerink Partners LLC, Research Division - MD, Medical Supplies and Devices and Senior Analyst*

I have 2 quick ones. Dan, just on the last question that was just asked with respect to guidance. So maybe there's a placeholder of some kind still for the Emerging Tech. But it sounds like it probably should be something less than the roughly \$10 million that we had talked about and that you had kind of blessed previously. First, is that correct?

**Daniel T. Scavilla** - *Globus Medical, Inc. - CFO and SVP*

I'm kind of smiling because I don't know if I blessed. But yes, I do think, again, Rich, what we're saying is we had put in a placeholder at the beginning of the year. We all talk about \$10 million just to let's see what we know. I guess what we're signaling now is we're uncertain of time. Again, I think 0 is the wrong answer because I believe strongly we've done all the right things to bring this to market and should do it in this year. I just don't know the selling cycle, the closing time, the install to give a number I'm overly comfortable with at this point.

**Richard S. Newitter** - *Leerink Partners LLC, Research Division - MD, Medical Supplies and Devices and Senior Analyst*

Okay. I guess then, if we just -- that does help, actually, so there's something in there. Just maybe less than \$10 million if that's what everyone was thinking. It's something less than whatever they were thinking. But if you were to back out the Emerging Tech contribution, it still implies a pretty steep ramp in the back half. You've talked about a number of reasons why that should accelerate for the U.S. growth rate off of low single digits. But it seems to me like your guidance still is implying kind of a high single-digit back half kind of core U.S. spine growth rate. Is that, in fact, correct? I mean, should we be thinking of this business moving into mid-single-digit territory as the acceleration or high single-digit territory?

**Daniel T. Scavilla** - *Globus Medical, Inc. - CFO and SVP*

I guess that would depend on your definition, Rich, not to be wise, but I think what will happen is you're coming into some different comps in Q3, Q4 that are going to raise you up, I think, into the mid -- just by themselves if you were to stay sequentially flat. And I think as we bring folks on board and have bigger contributions, I'm looking at a range that's going to be probably mid to upper. And what I mean by that is nowhere 9% or 10% but probably somewhere in between that range right now that would occur from change in comps and contribution of on-boarding for the U.S.

**Richard S. Newitter** - *Leerink Partners LLC, Research Division - MD, Medical Supplies and Devices and Senior Analyst*

Okay. And just to make it even simpler, maybe it's not 9% to 10%, but maybe something in the, call it, 6% to 9% range. Is that the range that we should look for?

**Daniel T. Scavilla** - *Globus Medical, Inc. - CFO and SVP*

I think so.



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**Richard S. Newitter** - *Leerink Partners LLC, Research Division - MD, Medical Supplies and Devices and Senior Analyst*

Okay. And one last one, on KB. Dave, it sounds like really what this is, is you're not buying a console. You saw some IP or personnel that, in some way, you feel like you can use or integrate to enhance the value proposition of your robot, and that's the rationale for why you bought KB. And then my second question is when you guys say near future and I think you said you anticipate a 3Q approval, how confident kind of are you in that roughly 3Q time frame?

**David M. Demski** - *Globus Medical, Inc. - Director and Group President of Emerging Technologies*

Sure. I think you stated it well in terms of KB. It's the IP and the personnel that are going to help us in the future as we go forward. And at this point, I feel very confident in the third quarter approval.

**Operator**

And your next question comes from Steven Lichtman of Oppenheimer.

**Steven M. Lichtman** - *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

Dave, I was just wondering on trauma where you are. I guess first in terms of the bag build-out, I think you talked before about getting to 70% of procedures being addressed here in the second half. And then second, how far along are you in the building out of the sales force there? How many reps are you looking to get to in the near term? And how far along are you to getting there?

**David M. Demski** - *Globus Medical, Inc. - Director and Group President of Emerging Technologies*

Sure, Steve. Thanks for the question. Very excited about trauma. We're getting a lot of positive feedback from surgeons who have come through and looked at what we're doing. We're about halfway through that core bag in terms of FDA approvals. A couple of significant systems are with them right now, and we're in the midst of responding to some of the questions they raised. So anticipate we'll be complete this year with that core bag. And we've hired almost all of our field sales management at this point in the third quarter. And they're going to be recruiting reps that are going to start for us in the fourth quarter. So we'll see a ramp in our expenses there. We expect to launch products. We're hoping to come out at OTA in October. So at this point, we're furiously building lots of sets and waiting for some of those products to be approved by the FDA. So fourth quarter, we expect to see some revenue.

**Steven M. Lichtman** - *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

You willing to give an approximate number of reps you're looking to come out with, the initial tranche?

**David M. Demski** - *Globus Medical, Inc. - Director and Group President of Emerging Technologies*

We're not sharing that right now, yes.

**Steven M. Lichtman** - *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

Okay, all right. And then, Dan, just a follow-up on the Alphatec dynamics. I just want to make sure I'm understanding. The elevated number is distributors that are continuing with you guys. Just want to make sure I understand. What is keeping that number higher than the sort of the \$40 million run rate that you had thought it might go to?

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**Daniel T. Scavilla** - *Globus Medical, Inc. - CFO and SVP*

Thanks. It's a couple of things, right. So keep in mind the \$40 million run rate was assuming that we would have all the synergies and attrition occur. And we kind of picked it all occurring into the Alphatec side, right. We just made that assumption that, that was it. So it's really a net number that was made to occur between core international and Alphatec. We just plugged it into one spot. We're absolutely seeing strength in our direct markets. David talked about Japan doing well and going forward, and again, there's a lot of strength there as there is with our other directs. We do retain several distributors. And what we're finding is we're actually selecting some of the Alphatec distributors who are actually adding more volume and better sales uplift than our own Globus ones. So it's really a combination of those 3 things. I'm just stressing again that it is not incremental to the core business, with some of that coming at the cost of us switching from the international core into Alphatec.

**Operator**

And your next question comes from Matt Taylor of Barclays.

**Matthew Charles Taylor** - *Barclays PLC, Research Division - Director*

I wanted to touch on 2 things. One was when we think about the moving parts in international with Alphatec and your core business blending, I was wondering if you could offer just some high-level thoughts on how you think about international growth at a high level over a longer period of time as you kind of get through the period of this integration.

**David C. Paul** - *Globus Medical, Inc. - Co-Founder, Chairman and CEO*

Thank you, Matt. This is David. So our market share for international, including Alphatec sales, is about 3.5%. So I feel like we have a long runway ahead of us to get to at least our 8% share that we have in the U.S. So we are looking at growing our international sales at higher rates than the U.S. And part of the reason we did the Alphatec deal was to accelerate that. Just a year ago, we were still looking at regulatory submissions in Japan and just thinking of how to get to Japan. But this acquisition has not only enabled us to get 4, 5 products approved through the PMDA but has also given us an immediate position of within the top 3 or 4 companies in Japan. So we're extremely pleased with this acquisition. But overall, I think we're looking for higher growth rates in the international over the next 5 years.

**Matthew Charles Taylor** - *Barclays PLC, Research Division - Director*

And I appreciate you might not typically want to give this level of detail, but given it's such an important assumption for the back half of the year and into next year, I was wondering if you could offer some quantification in terms of the net additions that you've had to your sales force. You've mentioned bigger than ever first half, but it's hard for us to quantify and think about how to forecast that over the remainder of the year. So anything that would help us with further color would be great.

**David C. Paul** - *Globus Medical, Inc. - Co-Founder, Chairman and CEO*

We typically don't give that color, Matt. Thank you for the question. But we just don't share those numbers for competitive reasons.

**Operator**

With no further questions, we will now conclude the Globus Medical Second Quarter 2017 Earnings Release Conference Call. Thank you all for joining us. You may now disconnect.



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