THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

GMED - Q4 2016 Globus Medical Inc Earnings Call

EVENT DATE/TIME: FEBRUARY 27, 2017 / 10:30PM GMT

CORPORATE PARTICIPANTS

Brian Kearns *Globus Medical Inc. - VP of Business Development*

David Paul *Globus Medical Inc. - Chairman and CEO*

Dan Scavilla *Globus Medical Inc. - Senior VP and CFO*

Dave Demski *Globus Medical Inc. - Group President, Emerging Technologies*

CONFERENCE CALL PARTICIPANTS

Matt Miksic *UBS - Analyst*

Jonathan Demchick *Morgan Stanley - Analyst*

Richard Newitter *LEERINK Partners - Analyst*

Matt Taylor *Barclays Capital - Analyst*

Kaila Krum *William Blair & Company - Analyst*

Bob Hopkins *Bank of America - Analyst*

Craig Bijou *Wells Fargo Securities - Analyst*

Jason Wittes *Aegis Capital - Analyst*

Kyle Rose *Canaccord Genuity - Analyst*

Steven Lichtman *Oppenheimer & Co. - Analyst*

PRESENTATION

Operator

Good evening. My name is Christina, and I will be your conference operator today. At this time, I would like to welcome everyone to the Globus Medical fourth-quarter and full-year 2016 earnings release conference call.

(Operator Instructions)

Thank you. Brian Kearns, Vice President of Business Development, you may begin your conference.

Brian Kearns - *Globus Medical Inc. - VP of Business Development*

Thank you, Christina. And thank you, everyone for joining 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.

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 FY16 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. 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 will now turn the call over to David Paul, our Chairman and CEO.

David Paul - *Globus Medical Inc. - Chairman and CEO*

Thank you, Brian, and good evening, everyone. 2016 sales grew by 3.5% as reported, reaching $564 million and full-year adjusted EBITDA came in at a healthy 37.4% of sales, but non-GAAP diluted earnings per share of $1.18. Sales for the fourth quarter grew by 6.3% as reported, reaching $151.6 million and adjusted EBITDA was 37.7% of sales and non-GAAP earnings per share was $0.31.

In many respects, 2016 was a great year for Globus. At the same time, it was one of the most challenging periods in our company's history. I am proud to say that our company has responded to that challenge, and we exit 2016 with a strong foundation to accomplish the goals we have set out for ourselves. On the positive side, we launched 17 new spine products; made important progress on our trauma and robotics initiatives; significantly expanded our in-house manufacturing; acquired and commenced a successful integration of the Alphatec international business. And last, but not least, continued to run an extremely efficient organization with adjusted EBITDA margins of 37.4% including the significant investments we are making in emerging technologies.

For the first time in our history, we saw sluggish sales growth not associated with a significant distributor loss. As we have discussed throughout the year, we had somewhat lost our focus on recruiting and experienced turnover among productive sales reps at a level not seen in the past. We have taken many steps to address both of these issues, which I will discuss in more detail below. And I believe our business hit an inflection point in the fourth quarter that we will used to build on throughout 2017. With these issues under control, the impending launches of robotics and trauma products and the easier comps we will face, we are very excited about 2017 and putting 2016 behind us.

As we look toward the rest of 2017, we are confident of growing both our top and bottom lines of all market trades within our core spine business. We are particularly proud of our margins as they continue to be best in class within the industry, with this marking Globus' eighth consecutive year of mid-30s EBITDA margins. We will continue to execute on our long-term strategy for success as we drive towards a $1 billion in sales.

First, we plan on driving innovation across the spectrum in spine to address unsolved clinical problems and to improve clinical and economical outcomes. Second, propelling sales force expansion in the US and the international markets, to grow Globus' distribution channels worldwide and compete more effectively with our larger competitors. Third, continuing to build out emerging technologies including robotics and orthopedic trauma. Fourth, putting our balance sheet to work by pursuing strategic M&A to augment internal efforts and fuel incremental growth.

On today's call, I would like to update you on several areas: efforts to rekindle sales expansion in the US, new product introductions, the Alphatec international integration and international sales expansion efforts, 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 US sales force expansion efforts. On the last call, we identified three specific issues that we were working on, recruitment, new territory development and retention.

On the recruitment front, I am happy to report that we have seen substantial progress in the recruitment of significant competitive reps and increased deal flow in our pipeline. Our efforts to be more aggressive with competitive reps, combined with acceleration of noncompetitive rep hires, are bearing fruit and this bodes well for improving sales growth.

On the development front, in the beginning of 2017, we realigned the goals of our sales management team to a primary emphasis on sales growth, and expect this model to take root over the rest of the year. While this is a change from our previous model, we see high-performing managers embracing and thriving under this realignment.

Turning to attrition, we took an active management role in understanding underlying issues and have taken steps to minimize any attrition with revenue loss, and I am happy to report that we are already seeing progress. We are confident that these efforts position us on a path of sustained, meaningful territory expansion, leading to increasing sales growth rates in 2017.

New product introductions: we launched two new products in the fourth quarter for a total of 17 in 2016, our strongest year of new product launches to date. I will now comment on some of the significant product launches in 2016. COALITION MIS launched earlier in 2016 as an anterior cervical integrated plate spacer inserted through a minimally invasive approach using either screws or anchors. Positive feedback on the ease of use of this system and flexibility to intraoperatively select screws or anchors, compared to competitive systems with anchors only, has enabled us to make further inroads in this ACDF market segment.

Our overall product portfolio strategy has been to focus and deliver game changing products by category that are designed to improve clinical outcomes and dominate the category. Our best in class integrated plate spacer portfolio for the cervical spine segment sets the standard with COALITION, COALITION AGX and COALITION MIS. And we are planning to launch further advancements to this portfolio in 2017.

INDEPENDENCE MIS was launched late in the third quarter, and we have seen appreciable lift in our ALIF portfolio sales already. INDEPENDENCE MIS is an integrated ALIF plate spacer system designed to simplify implant insertion and fixation to solve a common challenge inherent in the ALIF procedure.

Most integrative ALIF systems either use screws, which tend to require a much larger surgical access due to the insertion angle, or wide blades impacted into the bone, which can be hard to retrieve. The INDEPENDENCE MIS system features advanced instruments that can insert screws, or deploy three preloaded anchors through a small, protected corridor, no larger than the implant itself.

Certain feedback has been positive, and we look forward to seeing this product grow our ALIF business. As for the ACDF segment, we feel that our integrated ALIF offering is best in class now. With INDEPENDENCE, INDEPENDENCE MIS, MONUMENT and MAGNIFY-S, and we have more additions in the pipeline for 2017.

One of the most successful launches of 2016 was QUARTEX, a posterior cervical fixation system that offers a variety of solutions to the challenges associated with posterior OCT fusion. This fourth-generation posterior cervical screw system further strengthens our offering, delivering reliability and ease of use.

QUARTEX screw heads offer 90 degrees of conical angulation, and accept 3.5 mm or 4.0 mm rods in either titanium or cobalt chrome alloy. This system allows surgeons to take full advantage of thoracic anatomy through the use of larger screws up to 5.5 mm in diameter.

Refined instruments facilitate construct assembly with efficient reduction options and intuitive screwdrivers. Early positive feedback from our surgeon customers and the rapid adoption of the technology has forced us to buy more sets to keep up with demand in the field.

Ongoing innovative product launches in spine have been the lifeblood of our growth since inception. We intend to continue that trend in 2017 as several new products are on deck for launch.

Turning to international sales efforts, the Alphatec international acquisition added 27 countries to our global footprint, and we expect it to add $40 million in annualized revenue, almost doubling our international presence. Of particular note is our entry into Japan. We are pursuing an aggressive plan to gain PMDA and regulatory approval for numerous key Globus products in 2017 and we are investing in new sales territories in Japan to grow aggressively in an under-invested market. Outside Japan, we have begun the process of negotiating new Globus contracts with key international distributors to be completed by the end of 2017.

Further investments in sets and replenishment inventory are anticipated as we transition the customer base to Globus products. We expect this acquisition to add $0.08 to our EPS in 2018. This acquisition demonstrates our commitment to using our balance sheet to address key strategic needs in a responsible and profitable manner. Even with the acquisition, we hold only about 3% market share outside the US, so there remain ample opportunities to grow at rates higher than the US market over the near- to midterm.

On our core international sales, I expect us to return to the path for growth in 2017. A new sales management structure and harmonization of businesses -- business and sales processes with the US model will help achieve our goals of significantly expanding our presence worldwide with specific emphasis on Japan, the United Kingdom, Germany, Australia, and India.

Emerging technologies: the CE Mark Excelsius GPS system was showcased at the EUROSPINE and NASS conference late last year, and we continue to make steady progress in preparation for worldwide launch. In the US, we are awaiting FDA clearance and the excitement we have been hearing from surgeons on our robotics platform and how it integrates well into spine procedures make us bullish on future applications and synergies.

Our capital sales force has been hired, trained, and are ready to help Globus enter this in nascent, but potentially large market. Ours is the only product designed 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 on patient outcomes and safety has made us increase investments R&D, technology acquisitions and description channels.

On the trauma side, we have several products with the FDA, and expect to begin launching these products in 2017. 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 to reach $1 billion in sales over the next few years.

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. We are excited about our prospects as we continue to execute on our growth strategy of rapid new product introductions and worldwide sales force expansion, while maintaining our focus on profitability and cash flow.

Over the coming year, we are looking forward to getting our sales force expansion back on track, launching innovative new spine products, complete integrating the Alphatec international business and taking our first steps into the robotics and trauma markets. I will now turn the call over to Dan.

Dan Scavilla - *Globus Medical Inc. - Senior VP and CFO*

Thanks, David, and good evening, everyone. Full-year 2016 sales were $564 million, growing at 3.5% as reported, or 3.8% in constant currency, with GAAP net income of $104.3 million and non-GAAP net income of $114.5 million, delivering $1.19 fully diluted non-GAAP earnings per share and the 37.4% EBITDA.

Q4 sales were $151.6 million, growing 6.3% as reported, or 6.5% in constant currency against our toughest quarterly comp of the year. In addition, Q4 contained one less shipping day versus Q4 of 2015, and two less shipping days versus Q3 2016.

Q4 GAAP net income was $24.3 million and non-GAAP net income was $30.2 million with fully diluted non-GAAP earnings per share of $0.31 and 37.7% EBITDA. Full-year and Q4 EPS were impacted by approximately $0.01 for non-cash accounting adjustments and depreciation in inventory reserves. This change will not impact future period earnings.

Focusing on sales, the performance was driven by two main factors. First, international sales for the quarter were $24.1 million, growing 109% as reported or 111.8% in constant currency driven by the acquired Alphatec assets, which contributed $13.8 million for the quarter.

Our integration plan for market rationalization and distributor integration began late in Q4 and will progress through 2017. Based on this plan, we anticipate a $40 million full-year net contribution from the Alphatec assets. Second, US sales for the quarter were $127.5 million or negative 2.7%. Adjusted Q4 for the extra day shows an operational growth rate of negative 1.2%.

While this result falls below our long-term expectations, we saw some very encouraging signs in the fourth quarter that lead us to believe that have seen an inflection point. One, we address certain internal policies and processes and have seen a significant reduction in turnover from Disruptive sales reps in the second half of 2017 -- 2016.

Two, we intensify our recruiting efforts, and have become more aggressive in financial incentives to competitive hires with some important wins in late 2016 and early 2017. Three, looking simply at the numbers, growth in the fourth quarter reversed the trend from prior quarters.

In Q1 2016, we saw year-over-year growth of 6.3%; that dropped to 1.1% in Q2 and even further in Q3 to negative 4.1%. That declining trend was reversed in Q4 with the growth rate improving to negative 1.2%. The foregoing growth rates are adjusted to neutralize the impact of selling days between the years. Furthermore, we see these trends continuing in Q1 2017 performance and believe the positive momentum will continue in 2017 with quarterly improvements throughout the year.

Disruptive technology sales for the quarter increased to $72 million or 4.4% growth with continued strength in our expandable technology, COALITION MIS, INDEPENDENCE MIS, CREO MIS and Biologics. Innovative fusion sales for Q4 were $79.6 million or 8.1% growth, driven by Alphatec, QUARTEX and CREO pedicle screw system.

Turning to the rest of the P&L, Q4 gross profit was 74.3% including a 170-basis point impact for one-time prior year accounting adjustments and depreciation in inventory reserves, coupled with ongoing acquisition related costs. The branch medical benefit was $2.9 million in the quarter; in-house manufacturing will continue to be a strong counter lever to pricing and mix challenges as we continue to increase production capacity. Full-year gross profit remained strong a 76.1%.

Research and development expenses for the fourth quarter were $13.6 million, or 9% of sales. The increase is driven by continued investment in robotics, trauma, product development and one-time acquisition related expenses. We anticipate R&D expenses to be approximately 7.5% for full year 2017. Investments in emerging technologies impacted Q4 non-GAAP EPS by approximately $0.03.

SG&A expenses for the fourth quarter were $60.8 million, or 40.1%, driven by the inclusion of Alphatec international costs not present in Q4 2015. The income tax rate for Q4 was 33.4%, landing the full-year at 33.7%, a reduction of 100 basis points compared to 34.7% in full-year of 2015. The change in the effective tax rate is primarily due to the reorganization of our domestic legal structure.

GAAP fourth-quarter net income was $24.3 million versus $37.6 million in Q4 2015. The primary difference was the 2015 one-time gain in provision for litigation of pretax $11.7 million, coupled with higher 2016 acquisition costs. Adjusting for these factors, non-GAAP net income was $30.2 million in Q4 2016, $30.6 million in Q4 of 2015. Full-year 2016 non-GAAP net income was $114.5 million versus $108.8 million in full-year 2015. Our press release includes GAAP to non-GAAP bridges supporting these numbers.

Q4 GAAP diluted earnings per share were $0.25, and non-GAAP diluted earnings per share were $0.31. Adjusted EBITDA for the fourth quarter was 37.7% and 37.4% for the full year, driven primarily by the med device tax benefits and in-house manufacturing.

We ended the quarter with $350.8 million of cash, cash equivalents and marketable securities. Net cash provided by operating activities in Q4 was $51.9 million and free cash flow was $37.7 million. The Company remains debt-free. The Company reaffirms guidance for full year of 2017 sales of approximately $625 million, and non-GAAP diluted earnings per share of $1.27.

In 2016, we had a significant expansion in our audit scope, reflective of our growth in complexity over the past few years. As we work through the broader scope, we require more time than originally planned to fully complete the testing documentation of filing. We plan to file Form 12b-25 notification of late filing with the SEC to allow extra time to properly complete the audit. We anticipate the filing of the 10-K within the extension period. We will now open up the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Matt O'Brien, Piper Jaffray.

Unidentified Participant - - *Analyst*

Hello, guys, this is Matt in for Matt today. How are you guys doing?

David Paul - *Globus Medical Inc. - Chairman and CEO*

Good, how are you?

Unidentified Participant - - *Analyst*

Good. With the guidance that you guys just reiterated there, are you guys expecting to sort of return to organic growth in the first quarter, and how should we think about growth progressing throughout the year?

Dan Scavilla - *Globus Medical Inc. - Senior VP and CFO*

We do not intend to give out quarterly guidance, but I would tell you that the way we look now, we think we are going to move into a more flattish to slightly positive as we go in the first quarter. And I would anticipate that on a sequential quarter, having improvements until we exit it strong or higher single digit growth at the end of the year.

Unidentified Participant - - *Analyst*

Okay, great. And I think it was also recently communicated that you guys were sort of pulling back on the M&A strategy, in terms of building out sort of a more of a basic trauma bag? As a result of that, has that pushed back your internal revenue targets for 2017 and 2018 for trauma revenue?

Dan Scavilla - *Globus Medical Inc. - Senior VP and CFO*

No, not really. What we were saying out there was we had looked long and hard for the potential of a trauma acquisition to accelerate us into that field. But with the strength of our in-house capabilities, we are developing a basic bag now that we feel is better than what we would have acquired. So the move is not as critical as it would have been maybe, 12 months ago, although we will still continue that for size and scale and getting into markets with the right reps. But the bag that we are developing internally is probably stronger than anything we have seen as we were looking at the market.

Unidentified Participant - - *Analyst*

Great, thank you.

Operator

Matt Miksic, UBS.

Matt Miksic - *UBS - Analyst*

Hello, thanks for taking our questions. I wanted to get a sense, if we could, Dan or David, about maybe the components of growth in the fourth quarter as they pertain to your underlying growth of the rest of your business. Excluding some of the impact that you are still suffering from, the loss of these reps last year and the end of 2015. And then I had -- it would be very helpful, I think, for folks to understand maybe what the core growth of the rest of the business is as we turn into the year. And I have a follow-up.

Dan Scavilla - *Globus Medical Inc. - Senior VP and CFO*

So Matt, I think what I was pulling out with this, a couple of things. I think Alphatec acquisition delivered stronger performance and that was mainly due to us delaying some of the rationalization that we had planned to do. Certainly, a welcomed item. What we see is an improvement in the US more through just the programs we put in place and discussed on the call. And like I said, when you adjust that, you see an inflection point that is growing out there. International business is progressing, but certainly, right now the benefit of Alphatec is probably the bigger part of the international. Does that answer your question?

Matt Miksic - *UBS - Analyst*

Well, I was actually a bit more focused on the US. I think we understand the add of the Alphatec business OUS, but in the US, it strikes me that even though you have done some work to improve retention and improve your hiring, that you are still, you still lost a fair amount of revenue from the folks who left and are still kind of comping that at this moment, as you talk about your growth in the first half and then improving in the second half.

And I think last year, you had said something about the rest of the business, the core business, the [XB] losses was kind of growing at a -- I think it was at a mid- single-digit rate or something like that. But love to get the sense of what you are sort of not -- your territories where you have not seen a change, per se, or growing.

Dan Scavilla - *Globus Medical Inc. - Senior VP and CFO*

So you know one of the things we were talking about throughout the year of 2016 was we had some larger areas apart -- as you know, Q4 and into Q1, and that impact had taken us through Q2 to Q3. When you exclude that and look for more of the people who remained, that would certainly be into the teens growth as normal. So we did not see anything unusual with those territories and their continued growth there. It was just overshadowed by those larger impacts that we saw early on.

Really, I would think that by going in and changing some of the programs and creating a better retention level, we really saw that turn in Q4. And so in addition to the continued growth of the stable areas, we are doing those mid-teens, I would say, you start not only anniversarying, but seeing the improvements of the effects of the retention. And like I said, what we saw and not necessarily contributing in Q4, but we definitely saw, finally, movement in those competitive areas that we wanted, which I think sets the stage up more for 2017, second-half than anything.

So we are excited about that inflection point going from Q3 to Q4. It feels positive with the momentum that we have seen so far.

Matt Miksic - *UBS - Analyst*

And the other question that I am hearing from folks is maybe looking for a little bit more color and explanation around the prior period adjustment that you talked about. If you could maybe put this into context, when and if you have seen this before, just a little bit more color would be helpful.

Dan Scavilla - *Globus Medical Inc. - Senior VP and CFO*

Yes, so let me first say, these are absolutely non-material, no matter when you look at them. And so the thought was very simple as we did our [SAP10A] analysis just to take them all now and get them there. It really just relates to the fact that the way we were doing set depreciation was just slightly off, and over a couple of years, that accumulated up into something that was worth adjusting to make the balance sheet accurate and reflect through. So nothing to be concerned about, nothing big, but just the right thing to do to get us cleaned up as we discover what we were doing and how to fine tune it.

Matt Miksic - *UBS - Analyst*

Okay, thanks for the color.

Operator

Jonathan Demchick, Morgan Stanley.

Jonathan Demchick - *Morgan Stanley - Analyst*

Hello, thanks for taking the questions.

Dan Scavilla - *Globus Medical Inc. - Senior VP and CFO*

Thank you, Jonathan.

Jonathan Demchick - *Morgan Stanley - Analyst*

I had a quick question for Dan, just kind of following up on the 10-K filing. You mentioned it on the call, but I just wanted to make sure we fully understood what the delay really involved because this type of thing sometimes concerns investors. So it sounds like the commentary, it is really just the size of the business and the scope of the audit is, I guess, larger then you all anticipated? And is there something I am missing there? I guess I am trying to figure out what was different this year versus prior years?

Dan Scavilla - *Globus Medical Inc. - Senior VP and CFO*

No, I appreciate the question, Jonathan. And quite frankly, just would make sure that everyone kind of goes out and make sure they can put this on in an accurate fashion. As you will see, when we do our proxy, that this audit is of a size that we have not seen before. Going into areas that were previously out of scope, some of the international areas and yet many things that occur with us internally, just working through and fine tuning things.

And quite frankly, the timing of the audit just did not work out with us completing all of the ticking and tying with our independent auditors. So we stepped back a few weeks ago, decided the best thing to do was to continue in full force, get this done late. But make sure we let the public know we are just going to be a few days behind in getting this out there.

Jonathan Demchick - *Morgan Stanley - Analyst*

Understood, very clear. Thanks for the help. And just a quick follow up on margins, and really, just kind of the spending ramp that you are going to have this year. Obviously, there is a lot of moving parts. You guys gave pretty clear guidance on where you expect with the R&D numbers to kind of move. But as we think about through the year, and the progression of the ramp of hiring for salespeople in both trauma and robotics, how should we think about the incremental costs and where margins kind of move this year?

Dan Scavilla - *Globus Medical Inc. - Senior VP and CFO*

So I will tell you two things. We have a fairly full robotic sales force ready to go now. We had stepped that up into Q3, and we have carried that through Q4, so that is already reflected in the numbers that you are seeing now. We have really just begun putting some of the lead commercial folks in for trauma, and you will see that continue through Q1 and Q2. I do not anticipate any significant bleeds or anything that would really pull you off of us doing our mid-30s EBITDA number or coming out with the guidance for the bottom line that we have committed to. My thought would be that you are going to see a little bit heavier in Q2, Q3 and as we get more revenues, that would be offset in Q4.

Jonathan Demchick - *Morgan Stanley - Analyst*

Okay, and then just a quick follow up on the trauma side. I think you guys mentioned the launch in 2017, did you guys give anything a little more specific on that? Should we be expecting this more of a second half, 2017, late year -- what should we be thinking about on the launch there?

Dave Demski - *Globus Medical Inc. - Group President, Emerging Technologies*

Yes, Jonathan, this is Dave Demski. The second half is what we are projecting at this point for the trauma commercialization.

Jonathan Demchick - *Morgan Stanley - Analyst*

Thank you very much.

Operator

Richard Newitter, LEERINK Partners.

Richard Newitter - *LEERINK Partners - Analyst*

Hello, thanks for taking the questions. I was hoping -- (multiple speakers) Hello, how are you guys doing?

Just wanted to follow up on the -- thanks for the color on the expense cadence. But just -- Dan, you made a couple of comments a few weeks ago at our conference about EBITDA margin. Where -- my understanding was you guys were kind of saying at a mid -- or kind of 35% EBITDA margin, even in an investment year, which 2017 is. It is kind of the right way to think about your trough EBITDA margin, again, even during spending periods. And something north of 35% was kind of a flex payoff year. Is that -- one, did I hear you correctly, and is that the right way to think about your kind of the floor for your profitability?

Dan Scavilla - *Globus Medical Inc. - Senior VP and CFO*

Rich, the way we are looking now, we do think that 2017 would be more of that mid-30s. Keep in mind you are going to see with an approval some revenues coming out from robotics, and that is going to help, certainly, pay for the infrastructure and the commercial that we put in place. So that can actually get up to a neutralization, which will allow you to further continue to do your investments on the trauma teams. So I think that is good. Keep in mind, too, remember you have the med device tax repeal, you have the continued growth in branch, both of those power houses when it comes to the GP. So I really think it is the combination of those two, and the eventual revenue of robotics that allows you to deliver that mid-30s.

Richard Newitter - *LEERINK Partners - Analyst*

Okay, but we should still think of kind of a low-30s EBITDA margin as a -- during periods of investment as a possibility?

Dan Scavilla - *Globus Medical Inc. - Senior VP and CFO*

Yes, definitely. So keep in mind we are not going to go quarter by quarter, right? We will take any quarter due to the right investments, and again, if that gets down to the low range, we are okay with that. I think our commitment is probably landing 2017 within a 34 to 35 range with the investments we see in front of us, and that is what we are striving to do.

Richard Newitter - *LEERINK Partners - Analyst*

Okay, great. And would you care to comment a little bit, you said your robotics sales force is, more or less, built out and ready to go. Can you just give us a sense as to numbers or at least capital reps?

Dan Scavilla - *Globus Medical Inc. - Senior VP and CFO*

No, we do not tend to release anything with size just for competitive reasons.

Richard Newitter - *LEERINK Partners - Analyst*

Okay, and is it safe to assume that when you say your robotics sales force is built the that those are capital reps?

Dan Scavilla - *Globus Medical Inc. - Senior VP and CFO*

They are capital reps. And just keep in mind, you are going to have a group of hunters that do not need to be as large as our current sales force. So we are going to utilize and leverage the partnership with the current sales force, have these teams really focus on covering a larger part of the country.

Richard Newitter - *LEERINK Partners - Analyst*

Got it, and then maybe just two more. How should we think about lead times for developing a robot sale? And then just secondly, as we think about and refine our 2018 models, what -- and back half 2017 models, what should we think of the margin impact, particularly on the gross margin line, for a robot sale? Thanks.

Dave Demski - *Globus Medical Inc. - Group President, Emerging Technologies*

Rich, this is Dave Demski. Let me take on -- but just add to what Dan said about our robotics sales force. It is a highly experienced sales force in terms of capital. A lot of folks from -- with Intuitive, Mako, some Medtronics folks and Stealth on the team, so we are really excited about their capabilities. And the sale of capital is much different, as you know; it can take up to a year in the process.

We have plans to try to get outside the budget cycle and accelerate those purchase decisions once we are into the market. So again, we are pointing for more significant revenue in the last half of this year. And in terms of our margins, I do not think we are going to get into a granular kind of margins between our product lines and divisions at this point.

Operator

Matt Taylor.

Matt Taylor - *Barclays Capital - Analyst*

Hello, thanks for taking the questions.

Dan Scavilla - *Globus Medical Inc. - Senior VP and CFO*

Hello, Matt.

Matt Taylor - *Barclays Capital - Analyst*

Hello. Just wanted to circle back on some of your revenue targets for the new products, and I think before, you had talked about potential target of around $10 million for this year for robotics and trauma combined. Is that something you are still willing to sign up for, or can you give us any kind of color on the magnitude of the two competitors?

Dan Scavilla - *Globus Medical Inc. - Senior VP and CFO*

Yes, Matt, a couple things. Keep in mind that these products are certainly not approved yet by the FDA. So we just thought we would put a placeholder in, really, just for a combination of all emerging tech, just to say we anticipate some revenues later on. Obviously, we are waiting for approvals, it is out of our hands. And so that was kind of a placeholder that we think, should that come out, again, for us to have sales in Q4, it is achievable.

And quite frankly, if we find out that there is a reason why that may not be realized through emerging tech, we would think we could find those abilities to offset that in the core business, giving us growth or the Alphatec acquisition. So it is a number that we feel we can cover in total, and was just a representative until we get approval and find out we have more information to share.

Matt Taylor - *Barclays Capital - Analyst*

Okay, and just so I understand on Alphatec, because you currently had some out performance in the fourth quarter relative to your initial commentary. So you are talking about $40 million for 2017, could there be upside to that based on what has happened already, or are you now having rationalized that business back to a point where $40 million is a realistic number?

Dan Scavilla - *Globus Medical Inc. - Senior VP and CFO*

Yes, I do think $40 million is a realistic number. I do not think it is about just taking $10 million and spreading it or anything like it. I think we come into the year a little bit stronger because we had just begun in December, market rationalization and some contract terminations. There was even last time buys and things like that kind of lift up the number. So I think we will see that settle down throughout the year and get back to where we believe is $40 million, and that is probably more as you kind of walk through each quarter, and see it step down to a normalized level. Most likely, as we exit Q3, into Q4.

Matt Taylor - *Barclays Capital - Analyst*

Great, thank you.

Operator

Kaila Krum, William Blair.

Kaila Krum - *William Blair & Company - Analyst*

Hello, guys. Thanks for taking my questions. First, as it relates to Alphatec, can you just remind us of your multi-year plans there? I think at this point, you are still selling Alphatec products, so when do you expect to transition to Globus branded products, and what should we expect when that takes place?

And that in terms of competition outside of the US, I mean, you guys have done a great job at maintaining those Alphatec revenues to date, but would love an update as to what you expect or what you are seeing competitively, particularly in Japan.

David Paul - *Globus Medical Inc. - Chairman and CEO*

Kaila, thank you for your questions. As far as contractually, we have several years to transition from Alphatec to Globus products, but we are working hard to making sure that we can transition that in less than two years, and that is our initial plan. We are trying to accelerate that tremendously in Japan, and we want to be almost fully transitioned by the end of the year. But in other countries, we are hoping that within two years, we will have all of the products completely transitioned. That is the first part of your question, and can you remind me of your second question?

Kaila Krum - *William Blair & Company - Analyst*

Yes, sure. Just in terms of competition outside of the US, and specifically, within Japan. Again, you guys have done a good job of maintaining revenues to date, but I would just like to hear sort of what you are expecting, what you are seeing initially in Japan and other areas.

David Paul - *Globus Medical Inc. - Chairman and CEO*

Okay, to Dan's earlier point, we have done more than we expected to do with Alphatec so far, but that is before we have gone into market rationalization and changing over some contracts. So we think that there will be some drop-off, but then we also think that there is a tremendous opportunity to grow in Japan. We feel that business has been under invested in, and as we have been investing now and almost doubling the sales force there. And with the investment in sets and inventory, we think that there is upside to growth in Japan. We are not able to really quantify that, our first step this year is getting all of the products through the PMDA, and getting approved. And then we will have more color on that towards the end of the year.

Kaila Krum - *William Blair & Company - Analyst*

Okay, that is helpful. And then just on the 10-K extension, just as a follow-up. It sounds like this is a smaller issue, but can you just confirm, I mean, we are not going to see any surprises as it relates to historical revenue or margins when the 10-K ultimately does come out? And then just what preventative measures you guys have taken to ensure that we do not run into something like this again? Thanks.

David Paul - *Globus Medical Inc. - Chairman and CEO*

I do not think there is going to be any surprises when the 10-K is filed. Like Dan mentioned before, these were some larger scope issues from this year compared to years past. I do not see this issue continuing on. We are looking at all our internal controls and processes, and we do not expect this to be an issue going forward.

Dan Scavilla - *Globus Medical Inc. - Senior VP and CFO*

Yes, Kaila, we are not finding anything of concern. I just really think what it is, is quite frankly, a few things going on towards the end of year, larger scope than anticipated. Probably misjudged the amount of effort needed to get it done, and we need to just kind of work the hours at night and get this across the finish line.

Kaila Krum - *William Blair & Company - Analyst*

Cool, thank you, guys.

Dan Scavilla - *Globus Medical Inc. - Senior VP and CFO*

You are welcome.

Operator

Bob Hopkins, Bank of America.

Bob Hopkins - *Bank of America - Analyst*

Hello, guys. Good afternoon. Just a couple of quick fill-in-the-blank questions here. On the Alphatec side, you said a run rate of roughly $55 million going to $40 million, and you have talked a lot about it already. I am just curious, is that decline entirely rationalization, or are you still also forecasting some core underlying declines in the business?

Dan Scavilla - *Globus Medical Inc. - Senior VP and CFO*

No, it is really about rationalization, Bob. We saw the $13.8 million contribution in Q4. It is certainly stronger than we initially thought, but that we also thought we would have started that rationalization back in October, and we really took that into December.

As we look at this, we think Japan will grow. We have direct markets, which we need to work on to see what they will do, and we are making the assumption that a fair amount of the distributor business will probably transition away. Just based on what we have seen with other spine acquisitions and distributor channels in the past, and we think that projection is conservative given what we have realized and seen out there with other companies. So nothing really with the core so much as the distributor impacts.

One thing I will point out or highlight, though, to your question is as we do make decisions as to where we go, what we are doing, it is not always Globus wins versus Alphatec. So there are some key countries where we have decided to select the Alphatec distributors or other ways to go. And there will be a point, honestly, especially as we get into Q1, where it will get harder for us to untangle the core international from Alphatec. We will need to make a decision on what we can do with that. So that growth on the $40 million could have a slight down on the core and a little bit of strength in the Alphatec, and still net out in total to the $40 million.

Bob Hopkins - *Bank of America - Analyst*

Okay, that was just my confusion. So this is really all just your conservative assumption on the cost of integrating these two businesses. You are not actually shutting down business in any particular geography, and -- from a rationalization perspective. This is just the cost of integrating these businesses, and the decisions that you need to make. So --

---

Dan Scavilla - *Globus Medical Inc. - Senior VP and CFO*

Well, just to -- Bob, sorry, just one thing. There are definite markets that have been identified that we will exit that we feel, A, are not profitable, or B, may have a risk profile that we feel does not suit us. So we will absolutely walkway from some markets, we will rationalize others and where we can, certainly, invest and grow in the remaining.

Bob Hopkins - *Bank of America - Analyst*

Oh, okay. Could you quantify exactly the revenue amount of the businesses that you think aren't profitable and that you are going to close?

Dan Scavilla - *Globus Medical Inc. - Senior VP and CFO*

No, we really haven't. I think again, if you look through when we did acquisition, it probably had an annual run rate of being close to $55 million. We are throwing $40 million out there, so you can figure out it is really probably that difference is what we are thinking we would rationalize, walk away from, from a profitability or a risk point of view.

Bob Hopkins - *Bank of America - Analyst*

Okay, and I am sorry if I missed this on the robot, but -- I heard you on the $10 million placeholder, but since you have a sales force built out now, do you still think Q2 is the right timeframe for approval? Has there been any kind of issues back and forth in terms of questions from the agency, or do you expect Q2 approval?

Dave Demski - *Globus Medical Inc. - Group President, Emerging Technologies*

Bob, we are still hopeful that we will have that approval. We have not heard back yet from the agency, so it is still hard to handicap what their questions might be, and how quickly we can respond.

Bob Hopkins - *Bank of America - Analyst*

Okay. David, thanks very much.

Operator

Craig Bijou, Wells Fargo.

Craig Bijou - *Wells Fargo Securities - Analyst*

Hello, guys. Thanks for taking the questions. David, I wanted to start with you on the progress that you have been making on the competitive hires on the sales force. I appreciate the comments of you being more aggressive, but I did want to see if you could provide maybe a little more color and the environment that you are seeing. Because if we talk to your competitors, most of them are saying that they're net adders of reps and they are adding quality reps. So any color you can provide on the overall market environment for these reps, and then your -- the sustainability for Globus, specifically, to continue to bring them on.

David Paul - *Globus Medical Inc. - Chairman and CEO*

Thank you for your question, Craig. If you just look at the size of the Medtronic and the DePuy/Johnson & Johnson sales forces and their market share, just between those two companies themselves -- there is so much room for us to recruit their folks. And so it could be true that many of the smaller players are gaining from at the loss of those two larger players.

We have seen very strong competitive hires in Q4 and even into the first quarter of 2017. High-caliber reps, and we continue to see a pipeline that is full of competitive reps that we are looking to bring on-board this year. So I think somewhat it is a lack of focus on our part last year, and two quarters the year before, but I feel it we are well on-track to getting back our mojo on competitive recruiting.

The second piece that maybe does -- not as appreciated as -- late last year -- middle of last year, we started the noncompetitive rep program, where we are hiring reps without experience. [Junior] military officers and others that we are putting into our program, and developing them. And that has also seen a significant uptick in investment and in numbers of territories that we -- folks that we have brought on, with the ultimate plan of seeding them into territories in the near future. So both those categories make us feel confident about what 2017 is going to look like.

Craig Bijou - *Wells Fargo Securities - Analyst*

Okay, thanks for the color. And maybe, Dan, for you, on branch, you guys had -- when you did the acquisition, and subsequently, you guys had laid out a plan for the improvement, some metrics, some dollar amounts. I think it was $9 million in 2017, $15 million in 2018 of gross profit improvement, so I just wanted to get a sense, are those still the right numbers to be thinking about? And I think you also mentioned that you were going to be 50% in-house manufacturing by 2018. So is that still the goal, and is that still achievable?

Dan Scavilla - *Globus Medical Inc. - Senior VP and CFO*

Yes, Craig, you got it. You are spot on. So we probably did just shy of $6 million of a benefit this year, as I said, $2.9 million in Q4. We continue to invest and in that investment, we are able to expand production; I think we are probably up closer to 35% to 40% now. As we commission machines and get in it through 2017, we think we will be doing that production, as you said, at about 50% of our purchases in 2018. And so at a steady state like that, we ought to see in the neighborhood of $15 million per year benefit in the GP. And as we have said before, I think that is a wise investment that will allow us to counteract the single digit pricing pressure that we see combined with Biologic growth and international mix. All of those combine and allow you to say in that mid-70s GP.

Craig Bijou - *Wells Fargo Securities - Analyst*

Great, thanks for taking the questions.

Operator

Jason Wittes, Aegis Capital.

Jason Wittes - *Aegis Capital - Analyst*

Hello, thanks for taking the questions. Just wanted to understand the salesforce changes you mentioned. Is this a change in the way -- the commission base, or is this a complete change in the way the sales people are compensated?

David Paul - *Globus Medical Inc. - Chairman and CEO*

Jason, thank you for the question. No, the sales forces is always commissioned-based. I was just referring to the sales management team. And in prior years, we had it a mix of salary and commission and bonuses, and we tried to make most of the bonuses and commissions into growth bonuses.

Jason Wittes - *Aegis Capital - Analyst*

Okay.

David Paul - *Globus Medical Inc. - Chairman and CEO*

We decided to really focus them on growth on the sales management side, not on the territory level.

Jason Wittes - *Aegis Capital - Analyst*

Got it, okay, that is helpful. And then I wonder if you could comment on some of the thoughts out there in terms of the changing marketplace and how Globus is positioning itself. I think there is at least two trends emerging. The first one being that a lot of your competitors are becoming a little less stodgy on the product development front, and accelerating their -- both with their investment and pace of launches, number one. And number two, there seems to be consolidation of vendors at the hospital level. So how has Globus reacted to those changes, or do you have comments in terms of what you think about those changes?

David Paul - *Globus Medical Inc. - Chairman and CEO*

Thank you. Again, on the product development side, as I mentioned in my prepared remarks, we launched 17 new products this year, our best year ever. We continue to strengthen our product development team, and we think that we are second-to-none when it comes to not only ability, but also the pace of product introductions that we can bring year after year. That being said, a larger piece of our overall strategy is to diversify more into musculoskeletal so we can improve our footprint among hospitals and institutions.

As far as consolidation without -- within hospitals and accounts, we still feel like we have a very good shot at getting into any hospital based on our differentiated technology. And as long as we have price takers when it comes to Medtronic and J&J/DePuy, we have always been -- managed to get into those accounts.

Jason Wittes - *Aegis Capital - Analyst*

Okay, and then just one last quick question. I think you mentioned -- you commented on the robot, in terms of the central contribution from trauma, is there any baked into guidance? And related to that, what revenue level are you going to need within trauma to actually derive some profitability from it? Because my understanding is there is a fair amount of toolsets that you require to put out in the field before it really starts generating good profits.

Dan Scavilla - *Globus Medical Inc. - Senior VP and CFO*

Jason, it's Dan. So a couple of things, we think there will be some modest potential for revenues this year. Again, I think if we look towards a mid-year approval, and as we continue to fill out the bag, and then certainly, build up the sales force. We would hope to see something, but nothing that we are banking on that would take us off of our guidance right now. I think what you are saying makes sense, too.

I think this is a longer play where you make incremental gains year-on-year and get through there. Certainly need to invest in sets and get them in hospitals, and so our cash balance and our cash flow strength allow us to make those conversions and investments to get out there. And so I think our plan would be to develop the sets, get them approved, set up a basic level of reps, get successful, invest and build in concentric circles from there; very similar to how we built the spine business.

Jason Wittes - *Aegis Capital - Analyst*

Okay, is there a revenue number that we should look for as kind of a breakeven point for that business?

Dan Scavilla - *Globus Medical Inc. - Senior VP and CFO*

Hard to say right now. Let us finish designing the tools, getting them approved and seeing where they are and we will figure the rest of that out.

Jason Wittes - *Aegis Capital - Analyst*

Great, thank you. I will jump back in queue. Thanks for the questions.

David Paul - *Globus Medical Inc. - Chairman and CEO*

Thank you, Jason.

Operator

Kyle Rose.

Kyle Rose - *Canaccord Genuity - Analyst*

Great, thank you very much for taking the questions. Can you hear me all right?

David Paul - *Globus Medical Inc. - Chairman and CEO*

Yes, we can hear you, Kyle.

Kyle Rose - *Canaccord Genuity - Analyst*

Great, so a lot has been asked. Two, one more detailed question, and one more bigger picture question there. This is just the start -- when you think about overall sales rep hiring and additions, it sounds like Q4 was a positive improvement there. When you think about your net adds year-over-year when we think about 2017, can you just characterize that relative to where you are guiding the overall US business?

And then just taking a step back, from a bigger picture perspective, back at the Analyst Day back in 2015, you guided to a five-year revenue CAGR of 13%, with slightly faster EPS growth there. I just wanted to -- as we reflect on 2016, and then maybe some of the delays in the emerging technologies that are now going to start launching now. How do you think about that five-year guidance from a growth standpoint, and just kind of the growth assumptions that it assumes in 2019 and 2020 and beyond?

David Paul - *Globus Medical Inc. - Chairman and CEO*

I will take the first part of your question, and then pass the five-year one to Dan. In terms of the net adds in the US, the way we look at it is we are still outnumbered 5 to 1 by Medtronic in the US, and we feel there is a lot of room for us to grow our US sales force. That being said, a rate that we will look to see us grow is roughly the rate of sales growth, so if we grow at 10%, we would like to see our sales force grow at 10%. And we do not disclose those numbers, and when we measure ourselves, that is how we are measuring ourselves in having a successful year with sales growth.

Dan Scavilla - *Globus Medical Inc. - Senior VP and CFO*

Just to your question, Kyle, on the growth from the Investor Day. So there is a couple of things to think about, is we had always mentioned that the core business should grow at roughly a 10% CAGR for the spine, and if you remember, we were saying that, that means US is probably in the 8% to 9%-ish range. And we are looking to give it -- because of our under penetration internationally, to have that closer to the 20% for international type growth. So that is really what you would expect to see overall, somewhere between 10% or so in the core businesses as we get out in the next few years.

That change from that 10% up to the 13% CAGR is driven by spine -- or by emerging technologies with robotics, first and trauma, second. And that was really the lift that would get you up to the $1 billion market. Based on what we see today, we have talked during the Analyst Day that everything was organic, and we had levers to pull if we decided -- if we were coming off track. And as you know, we -- not because of our growth, but rather, it just happened to coincide, we were able to do the Alphatec acquisition. And that really covered the gap that we would have anticipated for 2016, and get us on track.

So we are still moving towards the $1 billion 2020. We will reevaluate that post approvals, and just see how it is later on this year, and just see if that needs a refresher. But right now, nothing we are aware of could take us off of that goal.

Kyle Rose - *Canaccord Genuity - Analyst*

Okay, great. Thank you very much for taking the question.

David Paul - *Globus Medical Inc. - Chairman and CEO*

Thank you.

Operator

Steven Lichtman, Oppenheimer.

Steven Lichtman - *Oppenheimer & Co. - Analyst*

Thanks. Hello, guys. Just two questions on trauma. In terms of the sales force build-out, I know you are pretty specific in terms of where you are on the robotics, but I was wondering if -- where you guys are at in terms of starting to build out the trauma sales force. And then secondly, just in the terms of the cadence of the launch, I think in the past, you have talked about after getting the initial products approved, you would still wait to get for a broader bag before going sort of full bore in terms of the launch. When should we start thinking about you really starting to go in earnest with a full launch in the US? Thanks.

Dave Demski - *Globus Medical Inc. - Group President, Emerging Technologies*

Hello, Steve, this is Dave Demski. Yes, in terms of the sales force hiring, we are looking at the second half of the year to really ramp that up, and going into 2018. And then we have a core bag that we are -- in development right now. Some of those products are with the FDA, some will be going to the FDA first quarter, second quarter here. But we are immediately moving our engineers into the next phase of products.

We will be layering onto that core bag immediately in terms of the development process. Now, it takes us 12 months to 18 months to get through that, but we see that as a continuous process. Very similar to the way we have approached spine, where we have come out with the basic elements and then continue to look for gaps and opportunities to improve patient care with technology.

Steven Lichtman - *Oppenheimer & Co. - Analyst*

But you will look to start the launch with the products that are FDA or soon to get to FDA?

Dave Demski - *Globus Medical Inc. - Group President, Emerging Technologies*

We will have what we consider our core group of products by the [set year].

Steven Lichtman - *Oppenheimer & Co. - Analyst*

Got it. Thanks, Dave.

Dave Demski - *Globus Medical Inc. - Group President, Emerging Technologies*

Yes, sure.

Operator

With no further questions, we will now conclude the Globus Medical fourth-quarter 2016 earnings release conference call. Thank you all for joining us. You may now disconnect.
