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GMED - Q1 2017 Globus Medical Inc Earnings Call

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MAY 03, 2017 / 9:30PM, GMED - Q1 2017 Globus Medical Inc Earnings Call

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PRESENTATION

Operator

Good evening. My name is Crystal, and I will be your conference operator today. At this time, I would like to welcome everyone to the Globus Medical First Quarter 2017 Earnings Release Conference Call. (Operator Instructions) Thank you. Mr. Brian Kearns, you may begin your conference.

Brian Kearns

Thank you, Crystal, and thank you all 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.

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.

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.



MAY 03, 2017 / 9:30PM, GMED - Q1 2017 Globus Medical Inc Earnings Call

Reconciliations to the most directly comparable GAAP measures are available in the schedules accompanying the press release and on the IR section of the Globus Medical website.

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

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

Thank you, Brian, and good evening, everyone. Our worldwide sales for the first quarter of 2017 were \$155.8 million, an increase of 11.9% as reported and 12.1% in constant currency over the first quarter of 2016. In the first quarter, we generated non-GAAP diluted EPS of \$0.32 and an industry-leading 37.1% in adjusted EBITDA. The strong first quarter results on the heels of our fourth quarter performance further indicate that we have passed the inflection point in returning to higher growth rates in our core spinal implant business by year-end.

We are very pleased with our performance during the first quarter. We launched 3 new spine products, received our first trauma 510(k) clearance, further expanded our in-house manufacturing capacity, had a strong competitive rep-hiring quarter and continued to run an extremely efficient organization with best-in-class EBITDA margins. We are also beginning to see our efforts to improve sales force expansion and productivity take root. With these issues coming under control and the upcoming launches of robotics and trauma products, we are very excited about our future.

As we look toward the rest of 2017, we are confident about growing both our top and bottom lines above market rates within our core spine business. We are particularly proud of our margins, as they continue to be best in class within the industry, with the first quarter marking Globus' 33rd consecutive quarter of mid-30s EBITDA margin. We will continue to execute on our long-term strategy for success, as we drive toward to \$1 billion in sales.

On today's call, I would like to update you on several areas: efforts to rekindle sales expansion in the U.S., new product introductions, the Alphatec International integration 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. We remain committed to improving recruitment, new territory development and retention. On the recruitment front, I am happy to report that we have seen a significant increase in competitive rep recruitment activity. We continue to see strong evidence in our current class of recruits and pipeline that Globus remains the destination of choice for the best sales talent in the industry, driven by our best-in-class product portfolio and robust product pipeline. Our efforts to be more aggressive in hiring competitive reps are bearing fruit, as the first quarter annualizes to more hires than any year since 2013, and we have a robust pipeline of recruits, which bodes well for future sales growth.

On the development front, our sales management team has instituted a program to maximize the number of new hires who are not competitive reps, who are likely to progress to a successful territory with straight commission.

Turning to attrition. We have continued to take steps to minimize attrition, and I am happy to report that we continue to see progress here as well. 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.

New product introductions. We launched 3 new spine products in the first quarter. I will now comment on 2 of these. We launched the rod-link reducer instruments earlier in the quarter for correction of complex curvatures in deformity surgery. We collaborated with Texas Scottish Rite Hospital, who developed a novel [inside 2] surgical technique to aid in the correction of severe spinal curvatures, leading to the development of a unique set of instruments. The technique increases leverage to manipulate the spine in the axial, coronal and sagittal planes simultaneously. Once the deformity is manipulated into a corrected position, the construct is locked in place, while a permanent rod is installed on the contralateral side. This launch marks another addition to our strong deformity portfolio of products. We are working on other unique solutions for deformity correction that we plan to roll out in Europe by the end of this year.

ViaCell is an advanced cellular allograft with the highest average cell count on the market. It contains an average of 700,000 cells per cc, 20% of which are mesenchymal stem cells and osteoprogenitor cells. ViaCell features the 3 key elements of bone repair and regeneration: osteogenic cells,



MAY 03, 2017 / 9:30PM, GMED - Q1 2017 Globus Medical Inc Earnings Call

osteoconductive scaffold and an osteoconductive growth factor. An optimized ratio of demineralized cortical fibers to cancellous chips in ViaCell is designed for enhanced cellular proliferation and exceptional handling. Early feedback from surgeons has been encouraging, and we are excited to have added ViaCell to our suite of regenerative biologics.

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

Turning to international sales efforts. The Alphatec International business added \$15.2 million of sales in the first quarter of 2017. We are pleased with the quarter, but continued to have discussions to integrate the Alphatec distributor network into ours. While we have maintained virtually all of the Alphatec business to date, we expect to experience some dissynergies as we rationalize some markets throughout 2017, and we are taking a prudent approach with guidance to account for this likelihood. We are particularly pleased with our progress in new product regulatory submissions in Japan, and look forward to introducing Globus products there in the second half of 2017. We are investing in several new sales territories in Japan to grow aggressively in a previously under-invested markets. Further investments in sets and replenishment inventory are anticipated, as we transition the customer base to Globus products.

On our core international sales, we continue to build out our sales management structure and to harmonize business and sales processes with the U.S. Our plan is to return to healthy growth by the end of 2017. Our effort to significantly expand our presence worldwide continues, with specific emphasis on Japan, the United Kingdom, Germany, Australia and India.

Emerging Technologies. The CE-marked Excelsius GPS system was showcased and well received at Eurospine, NASS and at the recently concluded ISASS conferences. We continue to make steady progress in preparation for worldwide launch, including logistics, supply chain, manufacturing and support. In the U.S., you will recall that we made the FDA submission in late 2016 and are working towards FDA clearance. Our 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 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.

On the trauma side, we have several products with FDA have begun receiving 510(k) clearances and expect to begin launching these products in the second half of 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 over the next few years, all in support of our drive to reach \$1 billion in sales.

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 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.

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

Thanks, David, and good evening, everyone. Q1 2017 sales were \$155.8 million, growing 11.9% as reported or 12.1% in constant currency against our toughest quarterly comp of the year. GAAP net income was \$28.7 million and non-GAAP net income was \$30.7 million, delivering \$0.32 fully diluted non-GAAP earnings per share and 37.1% EBITDA.

Focusing on sales, the performance was driven by 2 main factors. First, international sales for the quarter were \$26.1 million, growing 123.4% as reported or 126.5% in constant currency, driven by the acquired Alphatec assets, which contributed \$15.2 million for the quarter. We are very



MAY 03, 2017 / 9:30PM, GMED - Q1 2017 Globus Medical Inc Earnings Call

pleased with the top line and bottom line contribution of this acquisition to date. We are in the process of integrating the distribution network of the 2 organizations. To date, we have not lost any significant business as we have maintained parallel distribution in product lines, while we work through negotiations.

I would caution in extrapolating the Q1 results to the full year, as there remain significant risks that we experience some dis-synergies as we rationalize certain markets throughout 2017. The full year guidance we provided factors in the dis-synergies we believe are likely.

Second, U.S. sales for the quarter were \$129.7 million, 1.6% higher than Q1 '16 and 1.7% sequentially higher than Q4 '16. While this result does not meet our long-term expectations, we continue to see acceleration in growth and sequential improvements in the U.S. business, with year-over-year organic growth rates improving from negative 4.1% in Q3 '16 to negative 2.7% in Q4 to the positive 1.6% in the most recent quarter. We're starting to see the results of structural improvements we have made to the business and believe we'll see continued momentum and quarterly improvements to revenue throughout the year.

Disruptive Technology sales for the quarter increased to \$73.9 million or 6.8% growth with continued strength in our expandable technologies, COALITION MIS, INDEPENDENCE MIS, CREO MIS and biologics. Innovative Fusion sales for Q1 were \$81.9 million or 16.9% growth, driven by Alphatec assets, QUARTEX and the CREO pedicle screw system.

Turning to the rest of the P&L. Q1 gross profit was 77.2% compared to 77.4% in Q1 '16. This quarter included a onetime 120 basis point gain for vendor refunds and reflected the continued strength of our in-house manufacturing program, which contributed \$1.9 million in the quarter. Full year gross profit projections remained strong at 76%, incorporating the full year effect of price-pressure biologics and Alphatec product mix.

Research and development expenses for the first quarter were \$10.7 million or 6.8% of sales compared to 7.2% in Q1 '16. The increased spend in absolute dollar terms is driven by investments in Emerging Technologies and biologics.

SG&A expenses for the first quarter were \$67.1 million or 43% compared to 38.6% in Q1 '16. The increase was primarily driven by the inclusion of Alphatec international cost and the pre-revenue robotic commercial organization build that were not present in Q1 '16.

The income tax rate for Q1 was 32.3%, a reduction of 350 basis points compared to 35.8% in Q1 '16. The change in the effective tax rate is due to the Q1 '16 onetime negative impact for deferred tax assets related to the reorganization of our domestic legal structure. This was combined with an ongoing benefit for the adoption of ASU 2016-09 for stock compensation accounting beginning in Q1 '17.

GAAP first quarter net income was \$28.7 million, and non-GAAP net income was \$30.7 million. Q1 GAAP diluted earnings per share were \$0.30, and non-GAAP diluted earnings per share were \$0.32. Investments in Emerging Technologies negatively impacted Q1 EPS by approximately by \$0.04. Adjusted EBITDA for the first quarter was \$57.8 million or 37.1%.

We ended the quarter with \$389.2 million of cash, cash equivalents and marketable securities. Net cash provided by operating activities for Q1 was \$53.5 million and free cash flow was \$41.9 million. 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) Your first question comes from Matt Miksic.



MAY 03, 2017 / 9:30PM, GMED - Q1 2017 Globus Medical Inc Earnings Call

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

It's Matt Miksic from UBS. So I had one. I know you're not the biggest fish in the pond here in terms of spine in the U.S., but you're an important one, and I've asked the question of other folks in the quarter. And I just wanted to get a sense if you could give any color in terms of how the quarter sort of paced out for you in terms of seasonality or anything unusual when you look at year-over-year comps or missing days, or anything like that. That kind of sort of tone in the market would be very helpful. And then I have one follow-up.

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

Matt, thank you for the question. We didn't see anything unusual in the quarter. We had a decent quarter, not a great quarter, but we didn't see anything unusual from month-to-month in the first quarter.

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

That's helpful. And just a clarity on that. Can you remind us of what the impact of the sales rep losses were last year in this quarter? Or how -- was it a full quarter impact, partial quarter impact? Just trying to match it up.

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

See, we didn't really give out sales reps loss impact last year. If you remember, we lost some folks in Q4 of '15 and then into Q1. So it really stymied our growth in '16. But I don't believe we quantified a number for Q1 of '16.

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

Okay. I mean, partial quarter -- I guess, prior year partial quarter impact, and so I guess what I'm getting at is the second quarter, if I'm not mistaken, is it the right way to think about it that, that'll be, I don't want to say clean quarter, but it'll be sort of a full year-over-year, apples-to-apples growth?

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

Matt, the way 2016 unfolded, as David said, is we started to see some higher-than-average attrition occur in Q4 carried into Q1, and we really saw both Q2 and Q3 have an impact that occurred. From my numbers, I look at Q3 as probably the floor. That's what we called out the inflection point when we started changing around. So I still think you're going to see some change in those comps in both Q2 and Q3.

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

Okay, that's helpful. And then if I could, just one on -- another one of the topics that we get a lot of questions on, and I guess there is an open debate on how important robotics are going to be and, David, you mentioned you got some fairly good feedback and it looked like you were getting good feedback at ISASS. If you could give any color as to where you've seen more interest? Is it across the certain type of surgeon or a certain type of hospital or folks more interested in one element of the value proposition than another? Just what you've learned so far would be very helpful.

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

Thank you, Matt, for the question. When we started off what we really saw, an immediate impact was for deformity surgery and for MIS surgeons who are already familiar with MIS techniques. But as we have received feedback at these conferences, it's been pretty universal on how well it has been received. People like to use it in all sorts of applications, including deformity. Placement of screw seems to be the obvious immediate benefit

MAY 03, 2017 / 9:30PM, GMED - Q1 2017 Globus Medical Inc Earnings Call

. Our internal results are tremendous in terms of time, dose and inaccuracy. And as we have heard from surgeons at these conferences, they are pretty excited on how they can use this product to treat the gamut of spine surgery.

Operator

Your next question comes from Dave Turkaly.

David Louis Turkaly - *JMP Securities LLC, Research Division - MD and Senior Analyst*

Just a follow-up on one of those, the pricing in the quarter. Any color on sort of -- any changes there in terms of what you saw in 1Q'17?

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

Dave, no, actually we did, and we saw it really be relatively stable mid-single digits, did not see anything unusual in the first quarter from any of the previous quarters.

David Louis Turkaly - *JMP Securities LLC, Research Division - MD and Senior Analyst*

Great. And then just on the sort of your motion preservation technology -- it's been a while since, I think, we talked about this, but I was curious, could you give us an update on SECURE-C and maybe if that product is growing? And have you seen any impact since Zimmer bought LDR in terms of how that market is progressing?

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

Thanks for the question, Dave. We haven't seen any impact on the purchase of LDR by Zimmer. But we haven't been too thrilled about our progress with SECURE-C. We now have 7-year data coming out showing incredible results on cervical arthroplasty. We are looking forward to publishing this. Meanwhile, in Europe, we have 2 next-generation devices already being sold. So we are still excited about arthroplasty in the right indication, and we're just looking around seeing how the regulatory climate in the U.S. can potentially change, which would make us get much more active in clinical trials.

Operator

Your next question comes from Jonathan Demchick.

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

Just had a quick one on Alphatec. I was wondering if you could kind of walk through the rationalization process for the business. Clearly, the acquisition has outperformed, thus far, but it sounds like this outperformance is more slower winding down of the parts of the business that you may not keep rather than significant growth of the business that's staying. So I guess, I was hoping if you could kind of pare down those 2 parts, like: and how fast do you think the business is growing that you plan on keeping versus how much of the outperformance is really just kind of the winding-down process? And how long does that take?



MAY 03, 2017 / 9:30PM, GMED - Q1 2017 Globus Medical Inc Earnings Call

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

Hi, Jonathan, thank for the question. As I mentioned at the last call, we have an agreement with Alphatec for many years to have supply of their products. But what we are trying to do is make sure we get the registrations done in every country and then get the product rolled out -- Globus products rolled out, once we have a clear agreement with the distributor principles in that geography, if they don't overlap with the Globus. It's a little bit more complicated when they overlap with Globus. But even stepping further back, one of the primary reasons for us to do this deal was to get access to Japan, and that's what our excitement is really fueled by. We have -- a lot of our products are going through the PMDA process now, and we want to get these products out beginning of the second half of this year, and Japan's going to be much more than half of all the sales, and then that's what we are really extremely enthused about.

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

And just a follow-up on SG&A expense, it was a bit elevated this quarter. You guys outlined pretty well that it was related to both Alphatec as well as some of the pre-revenue for robotics. But I was also wondering if there was anything more onetime in nature there just given the strong rep hire quarter, or if we should be expecting basically that SG&A expense will, kind of, grow off of this level for the rest of the year.

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

Thanks, John. A couple of things. I mean, certainly, we have been communicating pretty openly that we will begin to have the robotic commercial team and eventually build up the trauma team out there. So no surprise that, that number is where it is right now pre-revenue with us. There is a few smaller onetime things that occurred out there, but nothing that I would say is worth calling out or looking at, just some basic timing things through the year. So it really is driven primarily by the inclusion of Alphatec followed by the increase as you start getting some of the salaries and annualization of salaries of that precommercial team. There is a few dribs of other things that just simply aren't meaningful to call out or model.

Operator

Your next question comes from Matt Taylor.

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

I guess I just wanted to understand, you talked a little bit about these product launches in the beginning of the call. Can you talk about how meaningful some of those are between the new Deformity addition and the allograft that you talked about? Are those something that you could see any inflection from?

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

Matt, thank you for the question. Let me start with the allograft. We've been speaking for a few quarters now about our efforts to grow out our regenerative biologics portfolio. We still feel like we need get to that 10% to 15% of our sales coming from regenerative biologics. We're getting closer to that point, but we are not quite there yet. And one piece that we did not have was a stem cell allograft product like ViaCell. And so we're really happy to have a really competitive product in that space, and we think this will be -- this will propel us to get to that 10% to 15% in biologics out of our total sales. The Rod Link Reducer product is something we're really excited about. It's a different technique of correcting deformity on the operating table, and we worked with the Texas Scottish Rite Hospital to develop this, and we made a unique set of instruments. We think it can be applied across all of our deformity systems, and we look forward to working with them and other deformity specialists to keep growing our presence in the deformity market. The last thing I'll say about the deformity space is we have many exciting initiatives ongoing internally on what we think will be the next-generation of treatment for deformity patients, and we are working on that. We want to see it come to market in Europe later this year and then later on we'll work on bringing these products to the United States also.

MAY 03, 2017 / 9:30PM, GMED - Q1 2017 Globus Medical Inc Earnings Call

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

And you provided some color on the investments in Emerging Technologies. So I was wondering how the investments in the new reps also kind of played into the margins this quarter. Could you talk about that, and how it will play out through the year as you get leverage from those investments?

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

Yes, Matt. It's Dan. So I would tell you that there's certainly an impact but it's pretty minimal, to be honest with you. We're going out securing competitive reps. We're doing some deals to get those out there. That's not creating any meaningful impact within SG&A. We can see a lift. But keep in mind as well you tend to have some revenues and all go with that. So the shift that I look at -- again, I wouldn't think it will be a main driver that takes us off.

Operator

Your next question comes from Craig Bijou.

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

I wanted to start, and I apologize if I missed this. But the \$625 million guidance for the year, you left that unchanged. And just given the Alphatec strong performance in Q1, and I recognize the comments about the rationalization of the business that's beginning to happen. But just wanted to get an understanding of if any of the components have changed the Alphatec, the \$40 million that you had talked about before, and then the \$10 million Emerging Technologies kind of placeholder that you guys put out there.

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

Thanks, Craig. I would tell you no. Just to be consistent, what we said through the year out on the street or at different healthcare conferences is we're pleased with where we're going, but we are going to wait until we get through Q2 before we make any type of change of guidance right now. I mean, as you already highlighted there's a lot of moving parts, none of which concern us. We have the upcoming rationalization of Alphatec distributors. We have the yet-to-be-approved robotic platform that's out there. And again, we're looking for that sustained return to the health of the U.S. business. We do want to get through Q2 before we reevaluate all that, make that call, and that's the real point right now of just holding off and maintaining the current guidance.

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

Okay. That's helpful. And then David, I wanted to touch on -- and maybe this is just what I heard in the script, but you said that you were, on the robot, you were working towards FDA clearance. So I just wanted to make sure or I wanted to see if you guys have been in discussions with the FDA, and if Q2 approval is still a realistic possibility.

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

Thank you for the question, Craig. It's really hard to predict with the agency. We've submitted in late 2016. We received some questions, which we are responding to now. And we hope to have a response back in soon and hope to get clearance shortly thereafter. I really cannot predict the timing. We're hoping we'll get it by Q2, but it's left to be seen.



MAY 03, 2017 / 9:30PM, GMED - Q1 2017 Globus Medical Inc Earnings Call

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

Okay. And just to follow up on that just, kind of joins in 2 of my questions. I mean is that \$10 million, Dan, I guess, this is for you, is that kind of going back to -- is that still a fair number to think about for the Emerging Technologies?

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

Craig, I would tell you yes for right now. Again, keeping in mind that it's pre-approval, and of course, our goal is always to surpass that, but let's go get the FDA clearance and then see how we can do it. So for now I'm modeling it without -- unchanged, until we get further data.

Operator

Your next question comes from Richard Newitter.

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

The first one on one of the new products you were talking about, ViaCell. Just remind me, when did you start selling that product?

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

In the first quarter of this year.

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

Okay. I guess, did you -- how significant was the trialing this quarter? Because one of your competitors called out competitive trialing from stem cell products, and I'm just wondering if kind of you saw better-than-expected success there. And then a follow-up on that is, how do you plan on tracking whether or not the initial use is trialing versus kind of actually sticky usage? Because we've tended to see doctors switch products pretty fickle within this category?

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

Thank you for the question, Rich. We launched the product towards the middle to end of the quarter. We have some great feedback early on. But we don't have a strong sense of how fickle or not fickle these users are going to be. The early users have liked it and have been repeat users. So I'd probably have more to comment about this in Q2.

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

Okay, that's fair. It's still early. Maybe just one follow-up on the robotics question. I appreciate that it's tough to predict the FDA, but maybe Dan you can comment on whether your \$10 million Emerging Technologies placeholder, is that something that let's just say FDA clearance were to slip into 3Q. I mean, is that something by default that you would have to change? Or does an approval have to come in 2Q in order to kind of get to your combined \$10 million trauma robotics figure for the year?

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

I would say probably not, Rich. I always went in and told everyone go heavy in Q4 with that just in case that occurs. So I would not be concerned if this were to bleed over into the beginning of Q3 and would not think it would take us off of any of our abilities to make the \$625 million. And



MAY 03, 2017 / 9:30PM, GMED - Q1 2017 Globus Medical Inc Earnings Call

again, as we said out in the street, there's a couple of levers we're holding back just to make sure, but we're anticipating the approval. If it slips even a little bit, we're not concerned about that.

Operator

Your next question comes from Matthew O'Brien.

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

Just to follow up on Richard's question. David, you mentioned these questions that you got back from FDA. Would you characterize those as out of the norm, any of them that stood out that are particularly problematic?

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

Matt, I really don't want to comment on our questions with the FDA. Suffice to say that we feel pretty confident on getting the clearance pretty soon.

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

Okay, fair enough. And then heading over to guidance, I know you don't want to talk about it. You don't want to change numbers at this point, but the domestic business did take up. It's got the toughest comp of the year, even if Alphatec were to slide down to the \$40 million that you've talked about, that would assume a pretty meaningful deceleration on a -- from a 2-year stack perspective in their domestic business. So the question is why would that happen? And then if you can comment within there a little bit about sales force attrition rate as you've been paying more attention personally from a management perspective or productivity of the newer reps that you hired kind of first half of '16, just how things are going with respect to some of those metrics.

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

So a couple of things, Matt. First off, sticking with the U.S. core business and its continued cadence, which is really driven by a stabilization of attrition as well as the onboarding of our reps. And so we're seeing that go through. We think that, that will have a decent cadence that will improve throughout the year as well as a change in comps. So it's really that combination that will occur for us to deliver what we consider that mid-single-digit growth within the U.S. core for this year. The Alphatec deceleration that occurs is really about the termination of the contract and shipping. So I think that's a fairly abrupt change that will occur. And again, as we work through that I think that will happen fairly rapidly as opposed to a slow bleed out, at least from what we're looking at or modeling now. I would tell you we're pleased with the efficiency of competitive reps that we brought on board throughout the year of 2016. And I think we're seeing the benefits that we would hope to see as we enter into the first part of this year.

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

Got it. Last question for me. On the trauma rollout, I'm going off of my memory, which is a little scary, but I think you had said maybe 7 to 8 product families that you'd be introducing right off the bat. How many of those families are approved? And then as we start to exit this year kind of selling those products, how quickly can you get some of those self-developed products into the U.S. and then maybe start to really accelerate share-taking in that category?



MAY 03, 2017 / 9:30PM, GMED - Q1 2017 Globus Medical Inc Earnings Call

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

Hi, Matt, this is Dave Demski. We're about 2/3 of the way through that core products bag that we had talked about. And we're looking at a second half launch somewhere late in the third quarter, early in the fourth quarter in terms of having reps and products available.

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

And the newer ones, Dave?

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

I'm sorry, the newer?

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

The self-developed ones, the kind of innovative disruptive-type technologies you're working on?

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

I guess I'm a little confused by the terminology. All of the products we're launching are self-developed and new. So I'm not clear on the distinction.

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

Sure. I think what you said, historically, is the first group of products will be kind of more me too-ish, and then you'll kind of come out with the differentiated ones later on.

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

This, actually, we have some differentiation built into this first wave. But there -- we're starting in, as we're working through the completion, as you complete the product, get it to the FDA, the tasks become more logistics and manufacturing, and those engineers are now cycling into newer products. So there's a second wave of products that we've begun development on. We won't see those in the market, probably not until the end of '18 at the earliest.

Operator

Your next question comes from Kyle Rose.

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

Just a lot has been asked, but I have 1 question on the disruptive side of your business. You're hearing more in the markets about competitive, either product launches and expandable cage market or planned product launches for expandable cages. Just wanted to see, obviously, you guys have really built that business over the past several years. So just, one, if you've seen anything today and then kind of what your guidance contemplates on underlying performance of the Disruptive Technology side of the business?



MAY 03, 2017 / 9:30PM, GMED - Q1 2017 Globus Medical Inc Earnings Call

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

Kyle, it's Dan. So a couple of things. I think folks will expand into this category. We had anticipated that for years. We see that as primarily a cannibalization of their static spacers more than coming after us. As we look at our own expandables, it remains a strong category, one of the highest growth categories for us as a product line, and we're not seeing, kind of, competition come in and create any level of disturbance as of yet.

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

Kyle, just to add to that we're on the third generation of expandable cages. We have built a tremendous portfolio, intellectual property portfolio, around our expandable cages. And we feel really confident about the portfolio we have and the lead we have. So we feel we're in a good position with expandable technology.

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

Great. And then just lastly on M&A, I mean, obviously, a very strong cash position and I think the question gets asked every quarter, but just as -- have there been changes to your thoughts on your capital deployment and where you -- how you view potential tuck-in acquisitions or M&A?

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

Yes. A couple of things. I mean, certainly, one of the first responsibilities for us in use of cash is going to be to feed and bring to completion the acquisitions that we have in process. So Excelsius to the market, finishing out branch manufacturing, filling out bone bank, they all remain one of the top priorities. Keep in mind with the Alphatec acquisition, the conversion from Alphatec products into the Globus products requires the investment of sets and implants and items that will occur. That said, we're still looking actively and have done several tuck-ins. We'll continue down that path to do that as the opportunities call themselves out.

Operator

Your next question comes from Kaila Krum.

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

So first one on trauma. So within trauma, can you just give us some color as far as initial feedback? I think you're sort of gauging market feedback a bit early on at AAOS. I'm just curious just what specifically the comments you're hearing related to those technologies there. And then with the late Q3, early Q4 launch, are you still comfortable with that \$2 million in sales as a fair target?

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

Thanks, Kaila. This is Dave Demski. We're getting some really excited feedback from trauma surgeons as they come through, and particularly there's several people who are helping us develop those products. And I think they're very excited about the innovation that we've been able to bring to the spinal implant business by carefully listening to our customers, understanding what the market needs are and marrying that up with our engineering prowess to come up with innovation. And they seem to be -- there's a sort of lack of attention to them historically that they're excited about us bringing there. So we're optimistic about that. And then in terms of the guidance we gave this year in the \$2 million, I think we're still comfortable with that, although as we get closer here, the manufacturing build that we need to do the launch is pretty important for us. But at this point, we're comfortable where we are with the guidance.



MAY 03, 2017 / 9:30PM, GMED - Q1 2017 Globus Medical Inc Earnings Call

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

Okay. And then just a follow-up on Japan. I mean, just how to think about Alphatec this year. I know we're fairly early as it relates to immigration, but just a bit more color around the market dynamic there, the conversations you're having with the nonexclusive distributors and shifting them over towards exclusivity. And then just any comments on the competitive dynamic would be helpful.

Anthony L. Williams - *Globus Medical, Inc. - President and Corporate Secretary*

Kaila, it's Anthony. So just to clarify, our organization in Japan is almost entirely direct. When David was referring to, or maybe it was Dan, was referring to the distributors, that's through most of the other countries that we acquired in that transaction. But Japan, well over 90% of our sales in that country are from the direct channel. But in terms of -- so in terms of the market plan, we've got -- we submitted a handful of products to the PMDA, as I'm sure you know that process is quite lengthy but we're working our way through. And we do expect to start getting clearances early in the third quarter with the expectation of getting those products launched as quickly as we can after we have approval. The direct relationship there is going to make that a little bit easier, and we think we can use some of our more advanced technologies to really grow the business in Japan through using those products.

Operator

And your last question comes from Steve Lichtman.

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

Dan, on the Alphatec rationalization, can you walk us through how you think the pace of discussions with distributors plays out over the next few quarters? Will those be complete near term and if the synergies build toward your estimates kind of a spike in terms of the impact? Or would it likely build over a number of quarters as you go through those discussions?

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

Yes. No problem, Steve. I think it's going to take us about 6 quarters to go through. It's something that we did begin and we called out in Q4. We started around December to look at this. And listen, there are several things you want to do. There are some countries that we may not want to be in for several reasons, be that size, profitability. There's others where we'd be willing to partner up with them, but we tend to look more for exclusive deals. And as you know, you're going back and forth with third-party, that takes a while to get through. So our thought and our model having started in December, you should see some of that action occur as we start getting deeper into Q2, be bigger into Q3. But it is going to be something that we carry out probably well into 2018 before we think we're at a finish point with the non-Japan markets.

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

Okay. Got it. And then, Dave, you mentioned beginning the sales force build on trauma, have you begun recruiting the field sales force? Or is it more leadership at this stage? How should we think about the build-out there and how big of a group you're expecting to get you maybe by the end of the year?

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

We began with the senior leadership at this point. During this quarter, we will start to recruit and hire some of the field sales folks, down to the rep level probably in the third quarter. And I don't think we've shared any numbers in terms of where -- what that initial build is going to be as is our practice in all of the business.



MAY 03, 2017 / 9:30PM, GMED - Q1 2017 Globus Medical Inc Earnings Call

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

Okay. But starting -- I'm sorry, in the second quarter, you'll start building the sales force?

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

The field sales management will be on-boarded in the second quarter. So you'll see a heavier spend there in the second and third quarters as we build up that team.

Operator

And this does conclude today's conference call. Thank you for your participation. You may now disconnect.

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