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Wright Medical Group N.V. Q&A

Wright Medical Group N.V. presentation delivered at the 37th Annual J.P. Morgan Healthcare Conference on Monday, January 07, 2019 at 2:00 PM

Robbie Marcus: First off, thank you for being here.

[background conversation]

Robbie: Thanks for being here. Maybe we could start with the results today. You pre-announced a really nice first quarter, a couple million above the Street.

Maybe you could walk us some of the pluses and minuses in the quarter, some of the drivers of upside and some of the areas that maybe didn't.

Bob Palmisano: As I mentioned in the room, we had to raise guidance three times in the second half of the year. The last time it was only eight weeks before the end of the year. We had a pretty good idea as to where we thought we would end up, which, on our base business, we ended up exactly where we thought we're going to end up.

We were a couple million dollars over the guidance, $2.5 million or so, simply because Cartiva came in stronger than we had anticipated. We expected more disruption and distraction as the integration went forward, and we had less than we expected.

Therefore, we were $2.5 million over. I think that the rest of the business just performed almost exactly like we had assumed that was going to perform. We ended up with year-over-year growth of about 12 percent, when you exclude Cartiva and include the four extra days. I think that was a pretty good year, good, solid year.

Robbie: Maybe we can walk through the different categories. Maybe we could start with lower extremity. Specifically in the US, you had some good growth finally in the second quarter, some nice growth in the third quarter.

How did that trend in the fourth quarter? Did you see the stability and the growth?

Bob: When you back out the effect of the four extra selling days, the effect of that was primarily in the US and primarily in lower extremity, is that you get pretty close to where we were in Q3.

That's what we planned for, we knew that was happening and that's where we gave the guidance we had. The business performed well, really rebounded dramatically from 2017, and we are well positioned into 2019 right now. We're in good shape I think.

Robbie: Is there any reason that we shouldn't take that fourth quarter exit rate in US lower business adjusted for the selling days and backing up Cartiva [inaudible] that underline US lower? Is there any reason we can't take that and carry that forward into 2019?

Bob: Julie would get mad at me if I started giving 2019 guidance, but we did give three-year guidance, which includes double-digit growth. You can assume that we anticipate getting to those levels.

I would also say that doesn't mean that every quarter, it's going to be over a three-year period, some things will go up, some things will go down, but over the period is that we feel very comfortable with our double-digit growth, and don't forget that's without Cartiva.

That is in the three-year number, but when you look at Cartiva next year, we're looking at double-digit growth. That's the information we gave you in the Q3 call for '19, double-digit growth plus the $47 million for Cartiva, that we've just talked about.

Robbie: You didn't change the $47 million for Cartiva given the better performance this quarter?

Bob: No, we didn't.

Robbie: Without getting Julie too upset, is it fair to say we still have an easy comp in US lower in the first quarter before we start to see the benefits from the expansion kick in?

Bob: We got a fairly good first quarter last year. That's when we started to see the rebound. I think there was a tougher comp in Q4 actually. It's hard for me to say. It's pretty neutral, I would say that.

Lance: If you think about on a proforma growth basis, when you think about Cartiva, Cartiva is going to have, actually, tougher comps in the first half of '19 and a little bit easier comps in the second half. You are asking about the base business but that's probably the one thing that really is. If you think about first half, second half, it's going to be tougher in the front.

Robbie: Are you going to be recording it on a proforma basis or on an organic growth basis next year?

Lance: We'll definitely do proforma and then beyond that. We'll discuss it on the Q4 call.

Robbie: Maybe sticking with lower extremity, you had a number of slides up there, some not-so-appealing slides on the lower extremity side. [laughs]

Maybe spend a minute walking us through the different key growth drivers for next year in terms of which are the most impactful two product launches that we can see in 2019 and then into 2020 as well.

Bob: We launched PROstep mid-year, August, September, I forget, somewhere around then and that we feel is going to be a big value driver, a big revenue driver in the future.

It has more of a learning curve for physicians than the normal procedures that they're used to. Not only medical education is important, but repeated medical education is important to get doctors up to speed to do these procedures because it's a much better outcome for patient. That's a big important part of '19.

Additionally in our businesses, in our internal, we combine lower and bio. AUGMENT injectable, as I mentioned, we've seen about a 30-percent increase in the growth rate with AUGMENT injectable as opposed to the other formulation.

That's part of it. Our total ankle business continues to grow around 20 percent every quarter, it seems. We think that will continue.

Robbie: How big is the total ankle, or as you call, the innovative business? What's the percentage split between [inaudible] less innovative?

Bob: That core versus other...

[crosstalk]

Julie: Technologically advanced.

Lance: I'm going to give you some growth rate numbers, but we haven't even broken out the specific pieces. On just the total ankle, you can back in to about where we are there, because we've talked about it being around $100 million market and that's having close to 70-percent market share. That gives you a feel for how much.

We haven't broken out all the other pieces, what we call technologically advanced.

Bob: The other piece of that product, technologically advanced, is Charcot. That is a high-ASP product, high-margin product. We have a number one position in that. It's important for us that that continue to grow.

Robbie: You mention the AUGMENT injectable. Outside the US, you saw that 30-percent positive increase with that. Can you talk to what you're seeing now, maybe in this quarter?

Bob: We're seeing about that same type of growth. We're seeing about 30 percent uptick in the growth rate with AUGMENT injectable.

It has a lot of advantages. The AUGMENT classic, as we call it, takes about 10 minutes to prepare. It's stiff and hard. You can't get it into some places. It has an odor to it doctors don't like. [laughs]

This takes about 90 seconds to prepare and just squirt it in. You can get into a lot of different places. Doctors tend to use more per case than they use on the classic. It really has performed pretty much as we thought but got there quicker than we thought.

Robbie: Any sense you could give us of what percentage of your usage is switched from AUGMENT to...?

Bob: It's over 90 percent.

Robbie: Because I remember as we came out of the summer, you were still getting through. Given the process [inaudible], you've made significant...

[crosstalk]

Bob: We're pretty much all through the [inaudible]. We're just going right now. It's been very nice.

Robbie: Still fairly early days but how much is AUGMENT injectable able to not just cannibalize the existing product but then also open doors and open up new accounts? Are you starting to get halo effect from AUGMENT injectable?

Bob: Yeah, we are. It's hard to quantify exactly how much, but I get reports from the [inaudible] all the time that, "Dr. Such and Such, we haven't been able to get there." We presented AUGMENT injectable. Now he's using it.

Now we're selling other stuff. It is a door opener for sure. As is Cartiva. Cartiva has the same effect.

Robbie: As we think about AUGMENT, the product family, where would you say the penetration is right now to what you see as the addressable market, and how big is that?

Bob: I think we're less than 10-percent penetrated right now.

Robbie: How big do you think the market is?

Bob: Market, about $300 million. About 100,000 cases, $3,000 ASP.

Robbie: Is there any potential for AUGMENT injectable to take that outside of hind-foot fusion and move it i[crosstalk]

Bob: There is. First of all, we're debating internally how best to use this platform that is AUGMENT. We can move into the mid-foot if we want. That would be relatively simple. We would like the FDA to give us a path that doesn't require further clinicals. I'm not counting on that.

Also, we're considering uses outside the foot. Before we acquired AUGMENT, the predecessor company had done work in rotator cuff surgery and tennis elbow that show promise. Those might be areas to get into also.

Robbie: We shouldn't probably think of 2019 as indication expansion but potential for maybe something...

[crosstalk]

Bob: No. 2019, I would definitely say that that's pretty safe bet that that's not going to happen, even if the FDA gives us some type of real break in what they want. This product just really got into the market third quarter of this year. We have the first six months before we anniversary it. It should give us some good upside.

Robbie: Anything else would need to be a PMA or...

[crosstalk]

Robbie: supplement?

Bob: Not sure. Not sure. It could be a supplement, or it could be a 510k. I've learned when you're dealing with the FDA if they're on the phone -- I love you guys -- usually it's the most...

Robbie: They're all shut down right now.

[laughter]

Bob: Maybe they are. Usually it's the most difficult thing that you can imagine is what they give you to do. [laughs]

Robbie: OK, good. Questions so far? Moving right along, the shoulder business. That continues to grow very nicely, double digits. With the fixation, the revision product that you mentioned on slides in the former presentation.

Maybe you can talk about what you're seeing in terms of market growth rates in shoulder both in the US and outside the US.

Maybe give us a flavor for competition, what you're seeing.

Bob: We're growing high teens. We have for the last year or two in shoulder in the US, maybe even above that, maybe in the low 20s.

It's a combination. First of all, it's a healthy market. The market's 8 to 10 percent growth. Our product portfolio, when we introduced PERFORM REVERSE product, really took off.

What's really driving the growth I think more than anything is competitive surgeons coming to use Wright products driven by BLUEPRINT. BLUEPRINT is the game-changer that appeals to competitive surgeons to change what they were doing and enter into us.

Just about every new converted surgeon that I have spoken to anyway said BLUEPRINT was the reason that they stopped using what they were using and started to use Wright medical products. We're seeing great growth, good markets, a strong market. We're growing about double the market.

Robbie: Do you see anything competitively close to BLUEPRINT?

Bob: No, I don't. No, I don't. This is a fundamental belief. I say this every year when I'm here, is that we believe very strongly in enabling technologies. I learned early on in medical devices that doctors will deal with products that are easier to use and give better outcome.

Easier to use is really critical. Our portfolio of PROPHECY in lower and BLUEPRINT in upper is just in that theme.

That's why we feel so strongly about this. We're investing heavily in BLUEPRINT. Now it's more pre-operative planning. Pretty soon it's going to get augmented reality, your artificial intelligence, which are big areas of improvement that'll even drive more business.

We're going to continue on this path. We have, as I mentioned, 30 people or so working full-time developing software for BLUEPRINT.

Robbie: You mentioned the revision shoulder. How should we think about the impact of sales...

[crosstalk]

Bob: It's hard to say. When we launched the revision product in ankle a couple years ago, what it did was it enabled more surgeons to do total ankle replacement because they had to bailout if something went wrong. In and of itself it wasn't that big a business.

Earn us hundreds of thousands of dollars as opposed to millions, but it performed. "If you use our products, you can use this revision system," was pretty appealing.

Now the shoulder is a little bit different. Implants have doubled in the last 10 years. The ones that were 10-years-old/12-years-old are going to start to fail.

This is the only revision product out there. A truly revision product that has specialized instruments, so you can take out the old one.

It has a technology that, when the new one goes in, that it's the right size, height, and everything. We estimate it at maybe a $70 million market. We're not going to get all $70 million, but I think that with this product we should get a good share of that.

Robbie: Right now it's a zero market.

Bob: Yeah.

Robbie: Anything competitive-wise that you see on the horizon in the revision market?

Bob: No. No one's said anything about it. We're the only people talking about it. Again, that gets down to that focus. We're in shoulders 24/7. Our competitors are in it part-time.

Robbie: When in 2019 should we get to see this? Was it the first half?

Bob: It's the first half, I believe. First half.

Julie: Yup.

Robbie: Question?

Audience Member: With BLUEPRINT and PROPHECY, do you get any price mounted out of those components?

Bob: No. We basically give the PROPHECY software to physicians free. We train them, but it's only useful in our products. It's in that growth rate and in that ASP.

We do have some guides that we do charge for, but it's not significant as part of the total surgery. PROPHECY's about the same thing. We get a little bit of money. Very little, but it's more included in the price.

The cost of using the software as opposed to a hardware or a mechanical solution like robots, etc., is significantly better.

Robbie: Lance, I see you were hoping I would let Bob answer all the questions, but I'll give you some financial...

[crosstalk]

[laughter]

Lance: It's fine. [inaudible] Bob.

Bob: Let him work for it. He got a promotion, you know.

Audience Member: Congratulations. We saw the new long-range plan put out this morning and the three-year outlook with double-digit constant currency top-line growth each year in those three years, a high set [inaudible], gross margin and growing from 17 percent EBITDA now to 20 percent.

Julie: More like 14 in three. [laughs]

Robbie: 14, I'm sorry. The 20 percent exiting, 20 percent for the fourth quarter in 2019 growing to the mid-20s in the three-year period. Help us bridge from 14 to 20 to mid-20s. Where do we see that come from?

Lance: Something about exiting 2021 in the mid-20s, so full year '21, it'd be a little bit less than that. We already gave some directional comments for '19, expecting about 300 to 400 basis points, EBITDA margin expansion with that being a little bit more than normal because of Cartiva. Cartiva's going to help with that in '19.

If you look at what's left, you probably have to do about the 250 basis points a year for the remaining two years to get you into that kind of range. That's about the range that we've consistently been doing over the last couple of years. The formula from here to there is pretty much the same as what we've been doing.

First is we need to get that double-digit constant currency growth, which we feel good about, obviously. Then, areas that we're going to leverage and not leverage, rep-level cost and R&D, we're not looking to drive any leverage out of. That's our competitive advantage. We're going to continue to re-invest in that at the rate of sales.

The rest in sales and marketing is going to grow, but if we're growing double digits, it doesn't need to grow double digits. Then if you look at our G&A and our logistics costs, which are pretty substantial, we have great leverage opportunities there.

In particular, G&A is something we think we can hold pretty flat over that period of time and get a lot of leverage. That's the game plan that we've been doing. We think we still have that over this period of time to get us into that mid-20s range.

Robbie: When your business is fully at scale, what do you think the potential EBITDA target is in the long run that you would be at?

Lance: I don't have a good number for that, but I would say it's definitely north of the mid-20s. If we can maintain high 70s growth margins, I said that when we gave the 20 percent goal. I said I didn't think we'd stop there.

I'll say that with the mid-20s goal, that I think sitting here right now, I think there would be further headroom. I think the mid-20s is a very solid amount of progress in three years. We should all feel good about that.

Robbie: And...

Audience Member: I'm sorry.

Robbie: No, no. Go ahead.

Audience Member: Just a very basic question. How do you have four less selling days in Q4? How does that shake out next year?

Lance: We're on a 4-4-5 calendar. We're not on a calendar year-end. Once every five years we have an extra week.

That was last year. The reason, it was four days instead of five was one of those days was Christmas.

That's basically how it shakes out. Next year we won't have that phenomena. That's how it happens.

Robbie: I know people haven't asked you about tax a whole lot. I looked across some Street models. Some people put tax rates in for you when you turn profitable next year. Some don't. What do you think the Street should be doing in terms of a tax rate? Are there NOLs that'll offset it for some time?

Lance: Yeah. I think from a cash tax standpoint, we're not going to have any significant cash tax payments for a while. We have a small amount now in individual jurisdictions where we have little pockets of profitability. We have around a billion dollars of US NOLs that is going to offset the majority of our cash taxes for a while.

As far as when we'll have a reported tax rate before we start paying taxes. The way the accounting works, I don't have a good prediction on when that is.

At some point, as we turn profitable, we'll release all the valuation allowance. We'll have an effective tax rate. We just don't really have a cash tax.

Robbie: 2020 at least, right?

Lance: Yeah. I don't want to give a prediction on that, but it's a little further out. That gets tricky with you and your auditors, and when you flip that and not. We'll try and give people plenty of advance notice, so as not to surprise people.

Robbie: Maybe a last question from me. Capital allocation -- you raised a significant amount with the Cartiva deal over the summer. Are you good for capital going into 2019?

Lance: Yeah. The way we think about capital is we have plenty of money to run the business. From an M&A standpoint, getting larger through M&A is not part of our strategy. That double-digit growth for the next three years is not relying upon M&A. We don't need a lot of dry powder to go execute the strategy or anything like that.

If there's differentiated technologies in our space, things like Cartiva, things like BLUEPRINT, we're going to want to go get those. I think we've shown that for those types of assets either...IMASCAP is a little smaller.

We were able to just handle that, or we could use our stock for the right type of asset. It'd be a positive for the company. We'd be willing to do that for the right type of asset again.

Robbie: Great. We'll leave it there. Thank you so much.

Bob: Thank you.

Julie: Thank you.
