THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

WMGI - Wright Medical Group NV at Wells Fargo Securities Healthcare Conference

EVENT DATE/TIME: SEPTEMBER 08, 2016 / 3:05PM GMT

THOMSON REUTERS

CORPORATE PARTICIPANTS

Bob Palmisano *Wright Medical Group, Inc. - CEO*

Julie Tracy *Wright Medical Group, Inc. - Chief Communication Officer*

CONFERENCE CALL PARTICIPANTS

Larry Biegelsen *Wells Fargo - Analyst*

PRESENTATION

Larry Biegelsen - *Wells Fargo - Analyst*

Good morning, everyone. I'm Larry Biegelsen, the medical device analyst at Wells Fargo and it is my pleasure to introduce Wright Medical this morning. With us, we have Bob Palmisano the CEO and Julie Tracy, Chief Communications Officer. In terms of format, it's going to be a fireside chat. If anybody in the audience has a question, please raise your hand and someone will come around with the mic. Bob and Julie, thanks so much for being here.

Bob Palmisano - *Wright Medical Group, Inc. - CEO*

Thank you, Larry.

,

Larry Biegelsen - *Wells Fargo - Analyst*

So Bob, I thought we would start with the Tornier merger. A little less than a year ago, you completed the acquisition. So tell us what the combination of Wright and Tornier created and discuss how the integration is done thus far, and where you stand in terms of completion of the integration process?

Bob Palmisano - *Wright Medical Group, Inc. - CEO*

Yes, it hasn't been quite a year yet. Thanks to the FTC, we had a long time to plan putting the companies together. And in summary, I think that we're really in a very good spot. When we announced the merger, we set out two pretty aggressive targets in terms of financial targets. First of all we said that we thought the combined entity could be a mid-teens growth Company, which was pretty aggressively because neither legacy Wright nor legacy Tornier at the time was a mid-teens growth company. But we set that as kind of a target understanding what we had in the markets that we were in and the products that we had currently in the pipeline.

Secondly, we set a target to be a high-70% margin Company. Again neither company was at that level, but we thought that putting these two companies, we could be there.

And we also said that we thought that we could be a 20% EBITDA Company three or four years post merger. So where are we today? I think that we are a mid-teens growth company. That happened faster than we had anticipated, and the result of that is both Q1 and Q2 we raised our guidance for the year, our revenue guidance. And we are a high-70% margin Company. And both of those things combined had given us some additional leverage on our EBITDA to get EBITDA going again faster than the we had thought, and we have again twice taking up our EBITDA guidance for the year. So a lot of hours working on that. We also said that we would have somewhere between $20 million and $25 million of dis-synergies, and we have said through the year that we think this as a worst-case scenario, is that we should do better than that perhaps in 2016, but in total when you consider the total amount, in 2017, the total should still be $20 million to $25 million of dis-synergies.

And then we said that we'd have $40 million to $45 million in cost savings. I think we've said that we're going to have about $20 million of that this year. So all that it is kind of working well. Operationally is what you don't see as investors and analysts; very complicated transaction. Thankfully, we had the experience of another transaction a while ago when we separated for MicroPort in which we had to stand up basically a new company. And this has been like that, so it took an awful lot of planning, things like merging 19 ERP systems into 3; very complicated, and then a whole bunch of other stuff.

Organizationally, we started out with an organization that has subsequently changed a little. We had a COO role. We don't have that any longer. We're more streamlined. We're making other changes, just fine-tuning kind of stuff, but we are in good shape. There is nothing negative that comes to mind or that I want to talk about in terms of the integration, the merger; it's all positive. We're either at or ahead of plan in all aspects of the merger and the integration.

Larry Biegelsen - *Wells Fargo - Analyst*

Perfect. Just sticking on the dis-synergies, I think you?ve started to see some at the end of Q1. That continued into Q2 in lower extremities, but you've also said that $25 million to $30 million or the $20 million to $25 million -- I can't remember the exact number, it's probably too high. But you expect to see some dis-synergies now in upper extremities, or you talked about some integration. I guess what I'm trying to understand is, in the upper extremities, why did you wait so long there to integrate the sales forces there? And it is going so well; if it's not broken why fix it?

Bob Palmisano - *Wright Medical Group, Inc. - CEO*

There is a distinction between integration and dis-synergies. For example, our lower-extremity salesforce is fully integrated at this point, but the dis-synergies follow that; they don't happen at the same time. They follow that. And the upper-extremity salesforce was quite different. First of all, it's a small amount of money, half the money at risk than we had in the low extremity. And we are generally not taking a rep from the legacy Tornier lower-extremity side, a rep from the legacy by Wright Medical legacy lower-extremity side and saying: one of you survives; one of you goes away, and the one that goes away takes business with them.

On the upper side; it's basically a handoff from a current legacy Wright lower-extremities rep that has some upper business handing that off to someone in the legacy Tornier side that's a full time upper sales person. And so the biggest barriers to over, the biggest risk was in the lower side. So, seemed like the sane way to do this was, don?t do this all at once; do this in sequence and take care of the biggest risks first and then move into the smaller risks. And that's what we choose to do, and I think that's working well. And I don't think there was any reason to think that we should do that, even looking back at it.

Larry Biegelsen - *Wells Fargo - Analyst*

So when we look at upper extremities, the culture of Wright and Tornier, I'm sure there are differences. So one concern would be that some of these legacy Tornier upper-extremity surgeons may not stay with the Company given the change in the culture. Is that a risk?

Bob Palmisano - *Wright Medical Group, Inc. - CEO*

Well, both companies had a culture, I believe, of being very customer focused. And don't forget, the senior leadership of Tornier were people that I had worked with in past. And we had a common management process, a common language of the way we prioritize and established a business process. So, both companies are very focused on the customer; did a lot of data gathering around customers; moved dramatically up in terms of customer willingness to recommend both Tornier and legacy Wright. So I don't think there is much of a cultural change as other companies might see, given that we had this kind of background that was unique. But having said that, we are taking very strong additional steps to keep everything going in a very, very positive direction.

I think that unless something happens that I am unaware of is that we have not lost any of our core design surgeons that work with us at all -- although it's generally speaking people work on a project; they go off a project and you bring new people in. But I think that it's all working pretty well. We just have a survey out in field now that we'll get the results of in another month or two that we'll be able to get some data behind, but I think that we are not -- from a cultural point of view, it's not big a gap as you might think.

Larry Biegelsen - *Wells Fargo - Analyst*

And then one area we did see disruptions was in lower extremities in Q2. Why did it take so long to show up there? And does the guidance assume that it gets worse in the second half?

Bob Palmisano - *Wright Medical Group, Inc. - CEO*

Again, we have this experience that we did when we sold of the hip and knee business is that -- again there's a big difference between integration and dis-synergies. So you do the integration in Q1 and Q2, but you don't get the synergies immediately -- is because the rep that is, or the distributor that is no longer with you that's going take the business, doesn't lose it immediately. It takes a transition period.

When we did the MicroPort transaction a couple of years ago, we thought that dis-synergies were behind us in Q1, and they were; they hit in Q3. And I think that that's what we were making people aware of here is that the integration took place but the dis-synergies lag that. And that, I think, is happening here. So there will be more dis-synergies in the second half, and I would particularly call out Q3. And we have said this from the very, very beginning that Q3 is when we think that the majority of dis-synergies in the low extremity is going to hit. And we will get a call at the end of Q3 and we'll be able to quantify that and see if that's true, but I believe it to be true.

Larry Biegelsen - *Wells Fargo - Analyst*

You talked about being a mid-teens grower once the integration is complete. Can you be more specific as to when you expect to reach that mid-teens growth?

Bob Palmisano - *Wright Medical Group, Inc. - CEO*

We'll reach that in Q2.

Larry Biegelsen - *Wells Fargo - Analyst*

It seems like, the guy who just said the second half is (multiple speakers).

Bob Palmisano - *Wright Medical Group, Inc. - CEO*

Don't forget that the majority of the low extremity dis-synergies and some of the upper extremities happen in the second half. So we will be in a mid-teens growth Company, excluding dis-synergies in the second half of the year, I believe; but the dis-synergies decline. And secondly, there?s seasonality year-over-year, but we did not have to pull our business together a year ago. So on a pro-forma basis, you might be able to put together, but I think that on an ongoing basis is that I think that we're -- on organic basis, I think we're pretty much there. It's a pretty remarkable story because neither company was that independently, but we are now.

Larry Biegelsen - *Wells Fargo - Analyst*

How long does it take for you to get there on a reported basis, not a --?

Bob Palmisano - *Wright Medical Group, Inc. - CEO*

We're going to have to anniversary some of these dis-synergies in 2017. So I would think as you go through 2017 and these things anniversaried in Q1, Q2, is that you will then see just the pure organic-reported growth rate. It'll pretty easy to discern though.

Larry Biegelsen - *Wells Fargo - Analyst*

And is it going to be pretty balanced growth across the three major growth drivers, upper extremities, lower extremities and biologics?

Bob Palmisano - *Wright Medical Group, Inc. - CEO*

Biologics are growing faster, but it?s a small part of the business. And I think -- we're not going get into 2017, but I think that both of these, the upper business and lower business, have significant opportunities in terms of new product pipeline that has been introduced this year, will be introduced next year, that should be able to, in total when we consider all three businesses, have this mid-teen growth profile for it.

Larry Biegelsen - *Wells Fargo - Analyst*

And that's adjusting for dis-synergies, which we will still see?

Bob Palmisano - *Wright Medical Group, Inc. - CEO*

You?ll see some in 2017. But as you get through the year, they'll be de minims.

Larry Biegelsen - *Wells Fargo - Analyst*

So switching gears to profitability, you guys have -- one of the rationales for the deal was to improve the profitability. You talked about that earlier but you exceeded your goals. And I guess you said it earlier, your goal is to be at 20% EBITDA margin three to four years post merger, but it looks like you're getting there making better progress than you originally expected. So I guess the question is, do you think we can get to 20% EBITDA margin sooner than three to four years post merger?

Bob Palmisano - *Wright Medical Group, Inc. - CEO*

I think I want to stay with that. Maybe when we give guidance for 2017, we'll take a look at that, but I think I want to stay with that now. Because I want to balance out growth and EBITDA. Is that I still think it's very, very important given that we are in underpenetrated and growing markets, is to keep the growth up so that we have the majority of the share in those businesses that we're in. And I think you could get to it faster if you were willing to sacrifice growth and we want to have that balance. And those three criteria that we set out: mid-teens growth, high-70% margins, and 20% EBITDA, I think are really good goals and have a profile of an excellent company. I don't know other companies that have that. Maybe there are some; maybe you are more aware of that than I am, but I think that that's pretty significant company with a great story behind it. So that's why -- I think we want to stay with that.

Larry Biegelsen - *Wells Fargo - Analyst*

Understood. So you're probably glad I waited about 15 minutes before asking metal-on-metal question? I haven't been as concerned about it maybe as some of my peers, right or wrong, but obviously you had a good update on the Q2 call. Should we think about -- I think what it, it?s $150 million to $198 million settlement range that you gave? Should we think about that as a worst-case scenario?

Bob Palmisano - *Wright Medical Group, Inc. - CEO*

Yes, I think that's the range that -- we think the settlement is going to be within that range. That's why we put it out there. The accounting rules are that you reserve at low end of the range for some reason, but that we think that it will be within that range.

Larry Biegelsen - *Wells Fargo - Analyst*

The question is that so you have three -- there could be upside because there are three insurers that are not part of the settlement. So that could be positive, but you're also going have claimants that are not part of the settlement and that could be an additional expense. I guess the question is, do you think it could be way out of that $150 million to $198 million range, or if it's a little bit -- it could be a little higher, it could be little lower; it's not going to be materially different (multiple speakers)?

Bob Palmisano - *Wright Medical Group, Inc. - CEO*

There are a couple of dynamics. One is that what settle with other three insurance companies for. That's a big piece of that to consider. And secondly, what claims won?t be settled by the overall settlement. Now if you look at the history of other companies that have been in this, generally they settled 90% plus/minus of the claims in the big settlement. I'm not going to give away everything, but I think that's out there. I also think that there are additional claims that have not yet been filed that could come into effect, that we have to cover. And additionally, there are some cases that are not what we call the MDL, which is the -- that are in different state jurisdictions. A small number, but we will have to deal with those. And then there's another group of cases that have things like statute of limitation arguments around them that we have to sort out, so to the extent we cover all of those, that will be a substantial part of the big cases, the revision cases. And so there will still some clean-up as all the other companies have had to do, but we think that the other side again is, what additional monies will be coming from insurance; we have to make sure that we maximize that as well.

Larry Biegelsen - *Wells Fargo - Analyst*

It's a public call, so I'll throw it out there. Is there anything new to report (multiple speakers)?

Bob Palmisano - *Wright Medical Group, Inc. - CEO*

No. There is nothing new. I think that we'll have an update on our Q3 call for sure. If something happens before that, either that we do reach the final agreement with the three carriers or the agreement with the plaintiffs is that we will get that out there right away. But we will give an update in Q3.

Larry Biegelsen - *Wells Fargo - Analyst*

Let me see if there are any questions in the audience. Some key new products we haven't talked about. If there aren't any questions in the audience, I'll ask one on AUGMENT. We were a little surprised that this question wasn't asked on the Q2 call, about the $10 million to $12 million in US sales in the first seven to eight months, the guidance that you gave; no one asked if you hit that guidance.

Bob Palmisano - *Wright Medical Group, Inc. - CEO*

Julie always warns me I can't talk about individual product lines, but I what I will tell you is that we're very happy with AUGMENT. It's going extremely well. And we think AUGMENT is a big deal. Our bio business is our fastest-growing business. We like the bio business. It performs more like other kinds of products. You don?t have the big use of working capital you have with the metal kinds of products.

AUGMENT is doing very, very well. And we are looking at ways of expanding the AUGMENT business. We are considering a couple of different things right now. An injectable form I think is something we want to get done. We saw a significant jump in procedures using AUGMENT in markets where we have injectable. We have to get that approved through the FDA. We are working on the regulatory path now to make it as shortened as possible.

Secondly, we're looking at soft-tissue applications as well as spine. Those are longer term; those are PMAs, but we feel that the product will definitely work in those areas. So concerning AUGMENT, we're very, very pleased with it. It's doing everything that we had thought. We are getting through -- the leading indicators of our success there are getting back committee approvals and getting surgeons trained. We were very successful in the first two quarters of the year doing that. There were no back committee meetings in July or August. That's just the nature of people away, and we did very little training, if any, in those two months.

It's picking back up now in September. So that's why we kind of said on our Q2 call is that Q3 is not going to be the same type of growth in general as this has -- I think we posted 50% growth in biologics last quarter.

Julie Tracy - *Wright Medical Group, Inc. - Chief Communication Officer*

Over 45% the last two quarters. And we've always said it's going to more of a steady build than this big ramp. So that's what you should expect.

Larry Biegelsen - *Wells Fargo - Analyst*

Two more on biologics. One, I was just wanted to push back a little bit on the $10 million to $12 million, because it is unusual for a company to provide guidance and not say whether they?ve hit the guidance or not. Just throwing it out there. You did provide the guidance. Second -- go ahead.

Bob Palmisano - *Wright Medical Group, Inc. - CEO*

I understand. We're saying is that as far as I'm concerned is that we did whatever we said that we were going to do.

Larry Biegelsen - *Wells Fargo - Analyst*

Fair enough. And then on the rest of the biologics business, has AUGMENT had a halo around business? You talked about (multiple speakers).

Bob Palmisano - *Wright Medical Group, Inc. - CEO*

We have gotten into accounts that we had never done business with. We are still -- have a long way and if you look at the what we call the upper-decile accounts, we're still underpenetrated in those accounts from a hardware point of view. AUGMENT is the door-opener in those accounts. And that has been working and I think that we're just at the beginning stages of that.

Larry Biegelsen - *Wells Fargo - Analyst*

So it's been a net positive because you were worried about it being cannibalistic?

Bob Palmisano - *Wright Medical Group, Inc. - CEO*

Well it's cannibalistic to parts of our other biologics to some extent, but it's a good cannibalistic. In that, the ASPs and the margins are much better on AUGMENT than they are in stuff that they are cannibalizing.

Julie Tracy - *Wright Medical Group, Inc. - Chief Communication Officer*

The halo, Larry, is not only just with other biologics. Obviously, a great halo effect is to have with our core hardware business as well. So outside of it too.

Larry Biegelsen - *Wells Fargo - Analyst*

And you are seeing that?

Julie Tracy - *Wright Medical Group, Inc. - Chief Communication Officer*

Yes.

Larry Biegelsen - *Wells Fargo - Analyst*

Perfect. Again, if there are questions from the audience, please feel free to raise your hand and we'll come around with the mic. We didn't talk about -- if there are no questions, I'll move to shoulders. We didn't talk about your new Simpliciti product the short stem, stemless, people use different terminologies, but we saw real acceleration in that business last quarter. You've attributed, I think, some of that, a lot of that to Simpliciti. So maybe if you could give people an update on how that's going; what's special about that product?

Bob Palmisano - *Wright Medical Group, Inc. - CEO*

Simpliciti has been in the market a little over a year now, and is doing terrifically well. It is a short-stem design, which gives increased range of motion; easier to install; you lose less bone, and doctors are using it on younger patients than the long-stem designs. We are the only person, I believe, in the market with this design. Other people are going through their work on this and there will be other people in the market, but we think we have a significant lead in it.

It's a great product for the reasons I just said. And the ASPs are about 60% higher than the normal anatomical shoulder. They are comparable to an inverse shoulder. So it's going well. In terms of our product pipeline is that we have additional products to follow on. We think that other people will be in the market perhaps in the next year or so, but hopefully at that time we'll have the next out because we have extremely robust product pipeline, particularly in the shoulder.

Larry Biegelsen - *Wells Fargo - Analyst*

To me, one of the most interesting things about the Simpliciti opportunity is the interest from non-Tornier surgeons. You have an opportunity to train competitor surgeons on Simpliciti because they all want to learn how to use it. If you think about the surgeons you have trained with a mix between legacy Tornier surgeons and new surgeons, can you give us any color?

Bob Palmisano - *Wright Medical Group, Inc. - CEO*

I don't have the percentage, but there are significant number of new surgeons. And the Simpliciti design not only works better for the patient than what I explained, but also is easier for the physician, for a lot of reasons. And so doctors that currently had to do this are very interested in getting into this product line and we are being very, very aggressive. We had 20% growth in shoulder in the US last quarter. Phenomenal business and I'm not going to say that we are going to do that every quarter, but we have a long ramp in front of us, and Simpliciti is the driving factor here.

Larry Biegelsen - *Wells Fargo - Analyst*

Who is next? Arthrex, Zimmer? Who are the other two? You talked about it in the last call.

Bob Palmisano - *Wright Medical Group, Inc. - CEO*

Yes, I think --.

Julie Tracy - *Wright Medical Group, Inc. - Chief Communication Officer*

Just the ones that we now have it.

Bob Palmisano - *Wright Medical Group, Inc. - CEO*

We know that they are working on them, and we also know they're still gathering data. So if you're still gathering data, you still have a ways to go.

Larry Biegelsen - *Wells Fargo - Analyst*

2017, did you stay on the Q2 call you would expect competition?

Bob Palmisano - *Wright Medical Group, Inc. - CEO*

I would expect something, maybe late 2017.

Larry Biegelsen - *Wells Fargo - Analyst*

And the one area pushback we heard and you alluded to is the price. People want to use it, but they are having trouble getting the hospitals to contract with you guys because of the ASP. How much of an impediment has that been?

Bob Palmisano - *Wright Medical Group, Inc. - CEO*

20% growth.

Larry Biegelsen - *Wells Fargo - Analyst*

Not much.

Bob Palmisano - *Wright Medical Group, Inc. - CEO*

I don't want to be cavalier about it but, don?t forget it is a very similar price of the new reversal shoulder. It's just different than an anatomical shoulder. And it's a better shoulder for most patients than buying normal anatomic shoulder (inaudible).

Larry Biegelsen - *Wells Fargo - Analyst*

We've got about three minutes left. I have a couple of additional questions, but please feel free to raise your hand. The one think I haven't heard people ask about is a sports med business. It's your smallest business. How do you -- you just divested the large joint business. How do you view the sports med business longer term? Is it strategically important and how do you grow it?

Bob Palmisano - *Wright Medical Group, Inc. - CEO*

I wouldn't say it's strategically important. We are -- it's a very, very small business and it's decreasing; it's not growing. So we have to figure out what to do. We are just giving sports medicine products to our lower extremities salesforce and they are making some progress with this. We're going to see if we can turn this from a negative-growth to a positive-growth business, unless it shows the characteristics of the rest of our business, which are high-growth businesses, high-margin businesses, we're going to have to reconsider the future of the sports med business. It's not something that I would say is strategically important to us.

Larry Biegelsen - *Wells Fargo - Analyst*

Understood. And then the Tornier large-joint business that you recently divested, I think you prepared well for that. But could you just give us some -- help reassurance that we won't see dis-synergies in the rest of your business from separating that business out?

Bob Palmisano - *Wright Medical Group, Inc. - CEO*

Good question. The large-joint business that we got was primarily -- it is all in Europe and primarily in France. And it was two different organizations. One for large joint, and one for extremity shoulder, upper extremities. So there was no loss there. The only area that -- from a commercial point of view, there's going to be no impact. The separation out of the organization, our manufacturing facility is another case is that that's a complicated issue just like when we did in the US with Salto. So we're working through that now. We have transition services agreements with the buyer, Corin, and everything is going fine, but that takes a lot of time and energy. And we'll be happy to get that out, but from a commercial point of view, there'll be no impact, no dis-synergies.

Julie Tracy - *Wright Medical Group, Inc. - Chief Communication Officer*

It's already two different salesforces selling it.

Larry Biegelsen - *Wells Fargo - Analyst*

Okay. 30 seconds left. I'm trying to think about time to get one more question in. Maybe on the total-ankle market, total-ankle replacement market, is it developing as you expected?

Bob Palmisano - *Wright Medical Group, Inc. - CEO*

It is a very fast-growing market. We're still underpenetrated; we're still in the second, third inning in the total-ankle replacement. We grew at 30% last quarter. And the market is probably growing in the high-teens or so, but we're driving that. We have a unique product in INFINITY. Certainly, even more unique is we have enabling technology called PROPHECY, which makes this procedure so much easier for doctors to do.

And other companies are developing implants, which is fine. And I'm sure they are very good implants, but they do not have the enabling technologies such as PROPHECY that we have.

Larry Biegelsen - *Wells Fargo - Analyst*

Perfect. Bob and Julie, thank you for joining us.