THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

WMGI - Q1 2018 Wright Medical Group NV Earnings Call

EVENT DATE/TIME: MAY 09, 2018 / 8:30PM GMT

OVERVIEW:

Co. reported 1Q18 results. Expects 2018 adjusted net sales from continuing operations to be approx. $800-812m.

THOMSON REUTERS

CORPORATE PARTICIPANTS

Julie D. Dewey *Wright Medical Group N.V. - Senior VP & Chief Communications Officer*

Lance A. Berry *Wright Medical Group N.V. - Senior VP & CFO*

Robert J. Palmisano *Wright Medical Group N.V. - President, CEO & Executive Director*

CONFERENCE CALL PARTICIPANTS

Christopher Thomas Pasquale *Guggenheim Securities, LLC, Research Division - Director and Senior Analyst*

Craig William Bijou *Cantor Fitzgerald & Co., Research Division - Research Analyst*

Glenn John Novarro *RBC Capital Markets, LLC, Research Division - Analyst*

Jeffrey D. Johnson *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Joanne Karen Wuensch *BMO Capital Markets Equity Research - MD & Research Analyst*

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

Lawrence H. Biegelsen *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Michael Stephen Matson *Needham & Company, LLC, Research Division - Senior Analyst*

Rajbir Singh Denhoy *Jefferies LLC, Research Division - MD, Equity Research & Senior Equity Research Analyst*

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

Robert Justin Marcus *JP Morgan Chase & Co, Research Division - Analyst*

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

Travis Lee Steed *BofA Merrill Lynch, Research Division - VP*

William George Inglis *Piper Jaffray Companies, Research Division - Research Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Q1 2018 Wright Medical Group NV Earnings Conference Call. (Operator Instructions) As a reminder, this conference call may be recorded. I would now like to introduce your host for today's conference Ms. Julie Dewey. Ma'am, you may begin.

Julie D. Dewey - *Wright Medical Group N.V. - Senior VP & Chief Communications Officer*

Thank you, and good afternoon, everyone. Welcome to Wright Medical's First Quarter 2018 Conference Call. We appreciate you joining us. I'm Julie Dewey, formerly Julie Tracy, Wright's Chief Communications Officer. With me on the call today are Bob Palmisano, Wright's President and Chief Executive Officer, and Lance Berry, Wright's Chief Financial Officer.

We issued a press release this afternoon regarding our first quarter results, and a copy of that press release is available on our Website at wright.com. The agenda for this call will include a business update from Bob, a review of our financial results from Lance, a question-and-answer session and then conclude with closing comments from Bob.

Before we begin, I'd like to remind you that this call includes forward-looking statements, including statements about our outlook for 2018. Each forward-looking statement contained in this call is subject to risks and uncertainties that could cause actual results to differ materially from those projected in such statements. Additional information regarding these factors appears in the section entitled Cautionary Note Regarding

Forward-Looking Statements in the press release we issued today. More information about risks can be found under the heading Risk Factors in Wright's most recently filed Annual Report on Form 10-K and subsequent quarterly reports on Form 10-Q as supplemented by our other SEC filings. Our SEC filings are available at www.sec.gov and on our Website at wright.com. The forward-looking statements in this call speak only as of today, and we undertake no obligation to update or revise any of these statements.

Our earnings release and today's discussion include certain non-GAAP financial measures. Please refer to the reconciliations, which appear in the tables of today's press release and are otherwise available on our Website. Note further that our Form 8-K filed today provides a detailed narrative that describes our use of such measures. Unless otherwise noted, today's results refer to results from continuing operations. Also note that, unless otherwise noted, all growth rates discussed today are on a non-GAAP constant currency basis compared to the prior year quarter.

Before I turn the call over to Bob and on behalf of Bob, Lance and our entire team here at Wright, I wanted to thank all of our analysts and investors who voted to recognize Wright's Investor Relations program in the 2018 Institutional Investor and IR Magazine Awards. Your continued support and feedback have been invaluable in our efforts to improve and further develop our program. And for this, we're truly grateful.

And on a personal note, as you can -- as you heard earlier, I recently got married and very much look forward to continuing to provide you with the excellent level of support that you've come to expect as the new Julie Dewey.

With that introduction, it's now my pleasure to turn the call over to Bob Palmisano. Bob?

Robert J. Palmisano - *Wright Medical Group N.V. - President, CEO & Executive Director*

Thanks, Julie, and welcome to our first quarter earnings call. We delivered strong results across the board in the first quarter, including over 9% constant currency sales growth, an estimated 250 basis points increase versus the fourth quarter of 2017. And we exited the quarter on a strong positive trajectory, which we expect to continue throughout 2018.

Our upper extremities business is doing phenomenal. Our lower extremity business is doing much better is on a positive trajectory. And we have several impactful new products launching later this year to drive further improvement. We also -- we will also not need to raise additional capital due to the successful resolution of the UK insurance dispute and additional financial capacity that was added to our existing loan agreement, which Lance will discuss later.

These results represent another outstanding performance in our US upper extremities business, which grew 21% in the first quarter, driven by 23.5% growth in our US shoulder business. We have strong contribution from our SIMPLICITI shoulder as well as the launch of our PERFORM Reversed Glenoid, which has been a clear winner for us.

For our BLUEPRINT enabling technology, we set a new record for Q1 in the number of surgeons planning and saving cases. We anticipate that our SIMPLICIT shoulder, our ongoing PERFORM Reversed launch and accelerating adoption of our BLUEPRINT enabling technology will continue to drive outstanding shoulder growth sales in -- throughout 19 -- throughout 2018.

After 2 years of relatively flat to down sales versus prior year, our US lower extremity business rate accelerated to 2.5% in the first quarter, driven by approximately 14% growth in total ankle and a return to our -- a return to growth on our core lower extremities business as we exited the quarter.

In addition, we continued to make strong progress in our ORTHOLOC ankle and small bone fracture product launches. Most importantly, we saw an increased benefit from the salesforce expansion and maturation, as evidenced by the return to growth in our core lower extremities business. While we're not ready to declare victory, this positive progress and our current trajectory are very encouraging.

Overall, first quarter sales growth improved significantly as compared to recent quarters, and we also delivered EBITDA margin expansion of 310 basis points, both of which we believe put us in a strong pathway for the remainder of the year and right on track to achieve our previously stated goal of adjusted EBITDA margins of 20% by the end of 2019.

While our first quarter results exceeded our expectations, we are not ready to increase guidance at this time and are reiterating our full year guidance, which calls for annual constant currency net sales growth of 9% to 11%, excluding the impact of the 4 fewer selling days in the fourth quarter of 2018.

I believe we are set up well for 2018 and beyond. We are in the 3 fastest growing markets in orthopedics. Our gross margins are outstanding. And our new product pipeline is full of innovative and commercially impactful products to drive continued growth across all parts of our business.

With that, I'll now ask Lance to provide further detail on our first quarter results. Lance?

Lance A. Berry - *Wright Medical Group N.V. - Senior VP & CFO*

Thanks, Bob. As we get started, please note that, unless otherwise stated, all of today's discussions regarding our sales growth rates refer to our constant currency growth rates compared to prior year quarter, and our results of operations refer to our as-adjusted results, which are non-GAAP financial measures, as described by Julie during the introduction of our call. Unless otherwise noted, today's discussions refer to results from continuing operations. Please refer to the non-GAAP reconciliations in our press release.

Globally, our net sales grew 9.2%. Underlying this performance was exceptional growth in our US upper extremities and 16% growth in the technologically advanced portion of our US lower extremities and biologics portfolio, which includes AUGMENT, SALVATION limb salvage, and total ankle replacement.

We also saw improved performance in the US lower extremities business overall in Q1 and in international net sales, which grew approximately 8%. Overall, Q1 net sales came in better than we anticipated.

Now moving on to some detail below the sales line, please note that all of my discussions will refer to our continuing operations results. Beginning with our Q1 adjusted gross margin, we achieved record gross margins of 79.7% for the quarter, a 30 basis point improvement over the prior year period.

As for the line items making up our Q1 operating expenses, selling, general and administrative expenses as adjusted totaled 69.1% of net sales for the first quarter compared to 72% in the prior year period, a 290 basis point improvement. This is more leverage than our full year outlook, partly due to strong sales performance and partly due to timing and spending that will catch up in Q2.

R&D expense as adjusted was $13.9 million in Q1 of 2018 and $12.4 million in Q1 of 2017. And finally, amortization expense was approximately $7.1 million in Q1 of 2018 compared to $7.4 million in the prior year period.

Below the operating income line, net interest and other expense was $7.9 million for Q1 of 2018 compared to $8.6 million in the prior year period.

For share count, our Q1 per share results as adjusted are based on average diluted shares of 105.9 million for Q1. Altogether, this resulted in adjusted EBITDA of $26.7 million and 13.4% of net sales for the quarter, a 310 basis point improvement over the prior year period. EBITDA margin expansion was better than anticipated due to the strong sales performance, record gross margins and some timing on sales and marketing spend. From a cash standpoint, our total cash balance at the end of Q1 was approximately $138 million.

With regard to cash, as previously disclosed in our SEC filings, we have been in arbitration with an insurance carrier related to coverage on titanium modular neck fracture claims. On April 11th, the arbitration tribunal issued its ruling. And as a result, we and the insurance carrier agreed to resolve the entire matter in exchange for a single lump sum payment by the carrier to the company in the amount of $30.75 million, representing the full policy limits of $25 million plus an additional $5.75 million for costs and interest. We received this payment from the carrier on May 8th, 2018. This insurance recovery will be reflected within the results of discontinued operations in Q2 2018.

We have also recently secured an additional $40 million of capacity under our existing loan agreement. Earlier in the year, we indicated that we would be evaluating our options for opportunistically enhancing our liquidity. The $30.75 million of proceeds from the insurance settlement combined with the additional $40 million of loan capacity refills what we used for the IMASCAP acquisition and provides us with adequate financial flexibility. Therefore, we have no further need for additional capital at this time.

From an overall capital structure perspective, our nearest maturity for our converts is over a year and a half away. So we have plenty of time to deal with those, and that just needs to be a refinance, not an incremental capital raise.

I will now discuss our 2018 full year guidance. Consistent with Wright's past practice, please note that our guidance ranges and assumptions for 2018 exclude any consideration for the effect of potential future acquisitions or any other possible material business development. Additionally, it is important to note that we will be using a number of non-GAAP financial measures to describe our outlook for the business. In particular, unless stated otherwise, all of today's discussions regarding our financial guidance refer to our as-adjusted results of continuing operations. Our press release issued today notes those items that are excluded from our as-adjusted results.

We continue to anticipate net sales for full year 2018 of approximately $800 million to $812 million. This guidance range assumes approximately 1% cushion from foreign currency exchange rates as compared to current rates. In addition, this range implies full year 2018 constant currency net sales growth of 9% to 11%, excluding the estimated $9 million impact of the 4 fewer selling days in the fourth quarter of 2018.

There is no impact included in this guidance for a US launch of AUGMENT injectable. We aren't providing any updated commentary on injectable today. As has been the case, we still expect that it will be approved, but we are unable to predict timing and therefore will not be including any impact in our guidance until the product is actually approved.

We continue to anticipate full year 2018 non-GAAP adjusted EBITDA in the range of $104 million to $111 million, as we expect revenue growth to drive continued leverage in SG&A. The company estimates approximately 106 million diluted weighted average ordinary shares outstanding for fiscal year 2018. If the company were in a net income position, diluted weighted average ordinary shares outstanding for fiscal year 2018 is estimated to be approximately 108 million shares.

From a quarterly cadence standpoint, we expect to see SG&A as a percent of sales to be higher in Q2 than Q1 due to the spending timing. Therefore, we expect EBITDA to be down slightly in Q2 from Q1 levels and then normal seasonality from that point forward.

In closing, we got off to a great start for 2018 and are right on track with our plans for the year. In Q1, our top line growth rate improved significantly as compared to recent quarters, and we delivered solid adjusted EBITDA margin expansion.

The upper extremities business continued to gain market share and deliver outstanding results. We've started to see improvements in the US lower extremities business, and with the slate of product launches in the coming months and a positive trajectory of salesforce execution, we are confident in our ability to get that business back to market growth rates as we exit the year.

We continue to deliver best-in-class gross margins and to drive EBITDA margin expansion and have ongoing opportunities for more improvement in this area. Overall, we are pleased with our start to 2018 and look forward to aggressively attacking the significant opportunities to propel the performance of the business the rest of the year.

With that, we would now like to open up the call to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question come from Lawrence Biegelsen from Wells Fargo.

Lawrence H. Biegelsen - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

So I was just wondering, on guidance, why you decided not to update it. Obviously, you delivered a 1Q beat, and you seem to be gaining traction on the lower extremity side. So just curious, what are you waiting to get a better handle on? Is it the salesforce productivity on the lower extremity side, or is it competition on the upper extremely side?

Robert J. Palmisano - *Wright Medical Group N.V. - President, CEO & Executive Director*

Well, it's just really -- right, I think we did get off to a great start in Q1. We want to see a little bit more of the year pass and how we execute along the way before we think about raising guidance. We give a great deal of thought to guidance, particularly at the beginning of the year and really work from a bottom-up process to give the investors kind of a good estimate. And although we had a beat in Q1, I just think it's too early to change now. As the year goes on, our feelings about that will change, most likely will change. But right now, I think that we want to stay where we are.

Lawrence H. Biegelsen - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Okay. Understood. And just as a follow up, I was just wondering if you can help us a little bit with the cadence of organic growth throughout 2018. Obviously, you did 9.2% in 1Q, and your guidance says 9% to 11% for the year. Thank you.

Robert J. Palmisano - *Wright Medical Group N.V. - President, CEO & Executive Director*

Yes, we expect our year-over-year growth to increase as we go through the year. And we -- our upper extremity business is extremely strong. But as we get later in the year, we're up against some very difficult comps because we launched the PERFORM Reversed Glenoid product I think in the second half of the year last year. So we have -- but on the other side, our lower extremity business has easier comps. So I think that, all in all, we expect to accelerate growth throughout the year. We expect to end the end of the year with our core -- excuse me, with our foot and ankle business back at market growth rates, in that 7% or so area. And that -- and with that, I think that we'll be able to deliver certainly the guidance that we have laid out so far.

Operator

Our next question comes from Glenn Novarro from RBC Capital Markets.

Glenn John Novarro - *RBC Capital Markets, LLC, Research Division - Analyst*

Bob, two questions on the lower extremities salesforce. You called out in your prepared remarks better salesforce execution. So can you quantify or provide any metrics that would help us better understand the extent by which the lower reps are performing better? So that's question number one. And then the second question, a year ago when you hired the lower reps, I think you hired around 100 reps. Are you still up a net 100 adds? Has there been any salesforce turnover? And if so, what's the characteristic of a new rep coming into the organization? Thanks.

Robert J. Palmisano - *Wright Medical Group N.V. - President, CEO & Executive Director*

Sure. Sure. And regarding the increased execution, I think a lot of it's maturity. These reps take a while to get up to speed. They're in surgeries, and they're dealing with products they haven't dealt with before, and it takes some time. But the evidence of the increased execution is that, last year, Q3, Q4, we were down to flat in that we didn't -- that -- in that -- now turning that around and being on an upward trajectory is pretty good. And I'd also say that, if you look at Q1, January was a tough month. And that had to do a lot with weather. I think a lot of people said that. Secondly, we had a little carryover of the supply issue related to the plasma coating on our total ankle that got resolved, but it affected us early in the quarter. And so in Q2 -- and February got better, and March was really, really strong. And so what we're trying to say is that the trajectory that that business is on is pretty good. That's why we feel confident that we can get back to market rates of growth. And that's how I would explain -- that's the evidence that our lower extremely salesforce is executing better and is maturing. The second question --

Lance A. Berry - *Wright Medical Group N.V. - Senior VP & CFO*

Are we still up 100 sales reps?

Robert J. Palmisano - *Wright Medical Group N.V. - President, CEO & Executive Director*

Yes, the -- we added -- we didn't quite add 100 sales reps. We added 100 sales territories, the difference being is that we promoted a number internally, but there was 100 new sales territories in -- that we added last year. And again, we started that process in Q2 and continue throughout the year. And there were quite frankly -- there were ups and downs in that. We did hire people both with orthopedic experience and nonorthopedic experience in the initial waves. We tried to do a great job training them. We did not have a lot of success, quite frankly, with the people that came from outside the orthopedic industry. They just didn't understand the -- seem to understand the pressures of the OR and our product line. And so we did have turnover in that group. I think we're back to pretty much normal turnover levels that we could normally expect where we are right now. But as we look back at last year, after the initial hiring in Q2 and the training is that there were some -- there were really some ups and downs. But I think that is significantly behind us.

Operator

And our next question comes from Mike Matson from Needham & Company.

Michael Stephen Matson - *Needham & Company, LLC, Research Division - Senior Analyst*

So Lance, I understand your comments around the balance sheet. Like you shored it up by about $70 million. But it also looks like your cash balance was down about $30 million from the fourth quarter to the first quarter. So can you maybe comment on that and just what your operating cash flow and CapEx were in the quarter?

Lance A. Berry - *Wright Medical Group N.V. - Senior VP & CFO*

Yes, part of that has to do with we're continuing to make payments on the first metal-on-metal settlement. We continue to make those throughout the quarter. So really a lot of that decrease in cash is associated with also a decreased liability there as well. Q1 is also usually a little bit heavier cash out quarter for us as compared to other quarters. So I don't actually have the actual cash flow metric excluding those, the metal-on-metal liabilities, in front of me. And maybe we could follow up offline. But we were actually looking at that earlier today. When you look at the cash decrease, there's also been associated liability decrease.

Michael Stephen Matson - *Needham & Company, LLC, Research Division - Senior Analyst*

Yes, okay, understand. So there were some kind of one-offs in there that are not reflecting the underlying kind of operating trends in the business.

Lance A. Berry - *Wright Medical Group N.V. - Senior VP & CFO*

Yes, unfortunately, with all the hip liability-related cash out, it's really hard just to look at the as-reported cash number. We raised money to pay for those things. And we have that on our balance sheet. I would say, overall, I'm viewing it as we've kind of had a net pickup of about the $70 million that we talked about from the arbitration settlement and from the additional loan capacity. And so we're in about a $70 million better off position from a liquidity standpoint, and we feel that's plenty adequate financial flexibility for us at this point.

Michael Stephen Matson - *Needham & Company, LLC, Research Division - Senior Analyst*

Okay. Thanks. And then just one product-related question. So the total ankle growth has slowed down quite a bit from what it had been doing in the recent past and well into the double digits. So why do you think that is? Is that a symptom of some of the salesforce issues you've had, or has the salesforce issues really been more confined to the kind of plates and screws and lower commoditized type products?

Robert J. Palmisano - *Wright Medical Group N.V. - President, CEO & Executive Director*

Yes, Mike, the -- we grew 14% I think in the first quarter, which was a pretty good number. And as I said, we still in the beginning of the quarter had some residual effects of a vendor issue that we identified last year. But I think that the technically advanced products in total are really growing nicely. I think the total is 17% or 18% and of which total ankle is a big part of that. The -- we have separated pretty much the salesforce into reps that are dealing mostly with these technically advanced products and reps that are dealing with more of the core products to get more -- quite frankly to get more of an emphasis on the core. The reps gravitated towards the higher ASP products and left the core products behind simply because they're -- the commissions were much better for them. So we divided the salesforce where we now have almost half our salesforce dedicated to core and the other half allocated to what we call the technically advanced products.

Operator

And our next question comes from Steven Lichtman from Oppenheimer.

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

As you mentioned, Bob, you saw acceleration in international this quarter. I know you've talked about it in the past. Obviously, that could be a lumpy business. Anything unusual in this quarter, or should we continue to expect that type of strength looking ahead?

Robert J. Palmisano - *Wright Medical Group N.V. - President, CEO & Executive Director*

I think the Q1 was more of a normal kind of a quarter for us. We didn't have any difficult comps to come up against, like we have sometimes. And we have big stocking distributor orders. I think it was a good quarter. It was a -- we expect our international business to be in this area of 8% approximately throughout the year. It may vary, one quarter be down and one quarter be up. But we're looking for that business to be at about 8% growth throughout the year.

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

Okay. Great. And then, Lance, just you mentioned on SG&A there was timing expenses. Relative to 2Q and beyond, what are the type of expenses? Are you still adding on the salesforce, and perhaps there was just some timing in terms of adds? What are the types of expenses that you said would -- are kind of more delayed into the latter part of the year from 1Q?

Lance A. Berry - *Wright Medical Group N.V. - Senior VP & CFO*

Yes, Steve, we didn't give color on the nature, but it's something -- given guidance for the year, and you have a view on how things are going to play out. But sometimes, you just see the spending slide a little more into one quarter or the next. So we were just highlighting we had a really strong Q1 from an EBITDA standpoint. We had over 300 basis points of margin expansion, which is pretty meaningfully more than what we expect for the full year. And we're just highlighting that some of that was just some timing spend that we expect will be caught up by the time we get to the end of Q2.

Robert J. Palmisano - *Wright Medical Group N.V. - President, CEO & Executive Director*

Yes, Steve, I would add to that that, coming off of last year, we were very cognizant that we didn't want to get spending out in front of us. So we took a very conservative point of view toward spending in Q1. Now those bills are going to come due at some point in time. I think that's what Lance was alluding to that we're going to -- as we go by to fuel the businesses, some additional spending will happen.

Operator

And our next question comes from Chris Pasquale from Guggenheim.

Christopher Thomas Pasquale - *Guggenheim Securities, LLC, Research Division - Director and Senior Analyst*

The shoulder performance was strong again here in 1Q. Wondering if you're willing to give us any metrics on the mix of that business today. And I'm thinking in terms of how big SIMPLICITI has gotten now as a percentage of the overall caseload and maybe the split between anatomical and reverse.

Robert J. Palmisano - *Wright Medical Group N.V. - President, CEO & Executive Director*

I think that these are -- I don't have the -- I'm sorry. Maybe you'll find it. I don't have the exact numbers. The big winner, the big growth area is in the PERFORM Reversed Glenoid product. That's been a huge -- we've had trouble keeping up supply in that product and the availability of kits to do the surgery. The demand is so strong. SIMPLICITI continues to be -- to grow very, very, very rapidly. There is a real movement, a real, real movement towards reverse. When we first got through the merger, it was about 60/40 in favor of anatomic. And now it's -- I'm sure it's over 50% reverse. So there is a big movement that way.

Christopher Thomas Pasquale - *Guggenheim Securities, LLC, Research Division - Director and Senior Analyst*

That's helpful. Thanks. And then, Bob, can you just give us an update on the PROSTEP US launch? That was a product that you guys seemed very excited about back at the Academy meeting.

Robert J. Palmisano - *Wright Medical Group N.V. - President, CEO & Executive Director*

Yes, the timing that we've said all along was Q3. This is probably the biggest product launch that we have had in the last several years. In getting ready for the launch, we're doing a lot of MedEd. This is a -- it's not an easy procedure. You're talking about minimally invasive surgery. But it's not easy. And one thing that we're very cognizant of, it's somewhat similar to total ankle. A lot of people, when we came out with INFINITY and INBONE said: Well, I tried total ankle a couple years ago. Then it was a disaster. And then we had the same -- there is a little reaction in the marketplace about minimally invasive surgery that the past entrants into this have had some difficulties. Now we're taking it slow. We're spending a lot of time on MedEd and making sure that our rollout is well sequenced. We have a physicians' preference testing group of several -- maybe 10, 20, 30 doctors. I forget the exact amount -- that are using the product now. And we've worked with them closely to refine everything about it. And we're all set to go in Q3. So this is a very big significant product launch. It will help us significantly in our core product areas. It's a product that will have a lot of usage in ASCs, which is a growing part of the market. And so we're real excited about it. And we're right on schedule for that launch in Q3.

Operator

And our next question comes from Travis Steed from Bank of America.

And I'm sorry, the line disconnected. The next question will come from Robbie Marcus from JPMorgan.

Robert Justin Marcus - *JP Morgan Chase & Co, Research Division - Analyst*

I know people have asked, but on shoulder, there's -- Zimmer's out there now with a stemless shoulder. I was hoping we could get your perspective on how that's impacting you in the US. Are you seeing any strong competition from them yet? And do you think this'll be a headwind going forward?

Robert J. Palmisano - *Wright Medical Group N.V. - President, CEO & Executive Director*

No, our shoulder business, including our stemless thing, is growing extremely rapidly. I don't know how they have launched that product, whether it's a limited launch or whether it's a full launch or even if this is the product they're going to go with long term. And whatever it is, I'm sure that they'll have a good product. But we competed against this product, the one that is approved, in Europe for years. And we're very successful in going head to head with that product. I also think that stemless shoulders are more difficult, generally speaking. That's what physicians tell me. And the implantation of them is more critical in that our BLUEPRINT enabling technology really helps here. And so as this market grows and the surgeon population expands into just away from people that specialize in stemless shoulders into more general population, having the enabling technology along with the implant I think will keep us growing and gaining market share. So no, we haven't seen too much of either competitor that has gotten approval. I expect that, sometime, we will. But we're in great shape. Our shoulder business is growing in the 20% area. And we think that can continue.

Robert Justin Marcus - *JP Morgan Chase & Co, Research Division - Analyst*

Great. Just as a follow up, your international business was particularly strong this quarter, even when backing out the impact of currency. Maybe you could just spend a minute on what's driving the outperformance there and if any of it's sustainable. Thanks.

Robert J. Palmisano - *Wright Medical Group N.V. - President, CEO & Executive Director*

Yes, the -- most of the growth, Robbie, came from our direct markets. So that is more sustainable than when we talk about stocking distributors. Stocking distributors are -- that business gets very lumpy quarter-to-quarter. And that business has evolved into mostly a biologics business. We do sell some hardware, but it's mostly bio that requires long lead times of product -- to make the products. So that does get lumpy. But the growth in Q1 really came from our direct markets, particularly in Europe. Robbie, excuse me, I would just add that the -- and it was heavily geared towards a lot of growth in upper extremity.

Operator

And our next question comes from Travis Steed from Bank of America.

Travis Lee Steed - *BofA Merrill Lynch, Research Division - VP*

So quick question on the stemless shoulder. What kind of feedback are you getting from your reps about what doctors are saying about some of the options in the market? And have you kind of identified the doctors who are most likely to switch? I'm just curious what tactics you're going at to keep those doctors.

Robert J. Palmisano - *Wright Medical Group N.V. - President, CEO & Executive Director*

Yes, well, I just talked about to the previous call about this. They -- we really haven't seen much of them yet. We don't know to what extent they've actually launched their products or whether they're just in a few selected sites. So our reps, quite frankly, haven't run across much of the -- either of the products that are currently approved, the competitive products that are currently approved. So our business continues to grow quite handsomely. So we'll be -- eventually, I'm sure that they will get more traction, get more kits out there and we'll see more of them. But as of now, we really haven't seen them.

Travis Lee Steed - *BofA Merrill Lynch, Research Division - VP*

Okay. And then the incentive comp headwind on EBITDA margin, in Q1, was that also 100 basis points? Curious if the headwind's kind of equally spread over the course of the year.

Lance A. Berry - *Wright Medical Group N.V. - Senior VP & CFO*

It is not. That headwind is more in the back half of the year than the front half of the year.

Operator

And our next question comes from Matthew O'Brien from Piper Jaffray.

William George Inglis - *Piper Jaffray Companies, Research Division - Research Analyst*

This is Will on for Matt. My first question goes back to the international strength in upper extremities. I was wondering if you could just provide a little bit more detail on what the key driver was there. Was it attributable to additional instrument sets being deployed?

Robert J. Palmisano - *Wright Medical Group N.V. - President, CEO & Executive Director*

Well, that's always a good thing. So yes, but I think that the PERFORM Reversed Glenoid product is really the driver of most of the growth.

William George Inglis - *Piper Jaffray Companies, Research Division - Research Analyst*

Great. Thanks for that. And then going to lower extremities, what gives you confidence that the core fusion products are rebounding? And if you could touch on just the acceleration in the quarter from March versus January, any color there would be helpful. Thank you.

Robert J. Palmisano - *Wright Medical Group N.V. - President, CEO & Executive Director*

Yes, the -- we were -- in Q3, Q4 of last year, we were either flat or down slightly. And the law of physics, an object in motion tends to stay in motion. So changing that trajectory is really, really important. And we -- that trajectory did change in a pretty good way for us in Q1 on those products. And we didn't really have -- we really didn't have the effect to any great extent of new products. That was just kind of a better execution by the salesforce in Q1. Regarding the second part of your question is the business progressed nicely throughout the quarter in Q1. January was a pretty poor quarter, and I think it was for most people in that there was a lot of bad weather in big cities. And a lot of surgeries that were scheduled didn't get done. So January was not great. February got better. And March was really strong. And so we exited the quarter on a trajectory that we feel very, very good about. And we see that continuing.

Operator

And our next question comes from Craig Bijou from Cantor Fitzgerald.

Craig William Bijou - *Cantor Fitzgerald & Co., Research Division - Research Analyst*

A couple follow ups here. On guidance, I know you guys -- it's still early in the year. You're not updating your guidance. On the last call, you did provide some guidance by upper extremities, lower extremities, a couple -- a little bit more detail. So any changes to that on a specific segment or product line basis?

Robert J. Palmisano - *Wright Medical Group N.V. - President, CEO & Executive Director*

No, (inaudible) but I think that what we're looking at is a year in which our lower extremity business accelerates through the year, and we end the year pretty much at market rates. We're looking at our upper business to be in the mid to high teens and our international business in the 8% or so area.

Lance A. Berry - *Wright Medical Group N.V. - Senior VP & CFO*

Yes, that's right. So we had a good strong quarter, but nothing at this point that we're ready to change any of our fundamental outlook for the year on.

Craig William Bijou - *Cantor Fitzgerald & Co., Research Division - Research Analyst*

Okay. Thanks. And then if I could just talk specifically about biologics, looks like it was down slightly this year in the US and international on a constant currency basis. I know you guys -- the comp is the toughest one of the year, but anything going on in that business? And then maybe if you could just talk about AUGMENT and what you're seeing there.

Lance A. Berry - *Wright Medical Group N.V. - Senior VP & CFO*

Yes, first of all, Bob talked about international that the bio business is a lot of where that stocking distributor business is. And I think, in the fourth quarter, international bio was -- even adjusting for days which don't even really impact stocking distributors was up over 20%. So that's just kind of normal variability there. Likewise, if you look at the US, if you adjust for the impact of the extra days, we had a decline in Q4 that was very similar to what we're seeing in Q1. So I would say no real change there in the US. It's really similar to what we've seen with the core bio, a bit more challenged, as we've talked about before, and AUGMENT growing faster. And then international is just somewhat lumpy. And we still think we'll have good growth in international bio for the full year.

Craig William Bijou - *Cantor Fitzgerald & Co., Research Division - Research Analyst*

And just to clarify, the AUGMENT mid-teens growth that you guys talked about on the Q4 call, does that still sound right?

Lance A. Berry - *Wright Medical Group N.V. - Senior VP & CFO*

Yes, we just said that AUGMENT is growing faster than the core bio and hadn't gotten into a lot more detail than that and that we certainly expect that for the full year AUGMENT to be the much faster growing portion of the portfolio.

Operator

And our next question comes from Raj Denhoy from Jefferies.

Rajbir Singh Denhoy - *Jefferies LLC, Research Division - MD, Equity Research & Senior Equity Research Analyst*

Wonder, Bob, if I could ask about any observations you have of the lower extremities market, particularly the core market because I think, as last year progressed, there was some commentary around pricing getting worse there and also, as procedures moved to the ASC setting, that there was a little bit more price sensitivity in that market. Has there been any change in the tone of that business? Is price getting better or worse?

Robert J. Palmisano - *Wright Medical Group N.V. - President, CEO & Executive Director*

No, we hear that from time to time about pricing and particularly as ASCs are more and more part of our market. What we're seeing is perhaps lower ASPs, as ASCs tend to like to price on a procedure basis. In other words, for a bunion, it's a price rather than charging for each part. But the gross margins are pretty much the same. And the evidence of that is that our gross margins were almost 80% in Q1. And so -- and core is a big part of our business. So I don't think that price in itself is driving anything. But I do think that ASPs are going to be lower, as ASCs tend to use fewer parts and get -- and like to have procedural pricing rather than individual parts pricing.

Rajbir Singh Denhoy - *Jefferies LLC, Research Division - MD, Equity Research & Senior Equity Research Analyst*

No, that's helpful. And I think part of what I think was perhaps driving that price a little bit was also competition. There were some low-cost providers maybe entering that core market. Have you seen any abatement of that trend or anything on the competitive side that's changed?

Robert J. Palmisano - *Wright Medical Group N.V. - President, CEO & Executive Director*

Well, you're right. There were -- as we exit -- as we separated from Tornier in the lower extremity business, a lot of those distributor reps that were formerly part of Tornier either picked up their own product lines or worked for the distributors, and they became competitors. And so that had an effect no doubt in 2017. I think this will continue. A lot of these products are not highly differentiated, but some of them are. I would draw -- excuse me, everyone's attention to our minimally invasive surgery platform, which we've talked about a lot. This is differentiated. It's really going to be very important to the -- to our core product line, very important in ASCs. It's differentiated not only in terms of the product offering, the actual hardware, but it's differentiated in terms of surgical technique and instrumentation. And so this'll be -- we are, quite frankly, better at products that have differentiation in them than just commodity products. And so as long as we can drive new products that are differentiated, we'll be able to I think get back in the great trajectory and also certainly not suffer pricing or margin issues.

Rajbir Singh Denhoy - *Jefferies LLC, Research Division - MD, Equity Research & Senior Equity Research Analyst*

Fair enough. Just one quick follow up. In terms of your outlook for market growth in the various segments, I think you noted earlier in the call you still think lower extremities is a 7% market growth segment. Any change in that or any subsequent change in the upper extremely growth as well?

Robert J. Palmisano - *Wright Medical Group N.V. - President, CEO & Executive Director*

No, and I think those growth rates are from everything we hear from us and listening to our competitors when they talk is that that's pretty much it. Our desire this year coming off last year is to get back to market growth rates in lower. And we're looking at 2x market growth in the -- at least 2x market growth in upper.

Rajbir Singh Denhoy - *Jefferies LLC, Research Division - MD, Equity Research & Senior Equity Research Analyst*

And that upper growth is what, sorry, just the market just --

---

Robert J. Palmisano - *Wright Medical Group N.V. - President, CEO & Executive Director*

Yes, the market growth is in the same area, 8% or 9%, something like that.

Rajbir Singh Denhoy - *Jefferies LLC, Research Division - MD, Equity Research & Senior Equity Research Analyst*

For upper.

Robert J. Palmisano - *Wright Medical Group N.V. - President, CEO & Executive Director*

Yes, there's not a fine scientific database there. It's just what everybody kind of agrees around that, around 8% or something.

Lance A. Berry - *Wright Medical Group N.V. - Senior VP & CFO*

Yes, we kind of talk about 7% to 9% in general for the upper. And it probably fluctuations a little bit time to time. But it's in that high single-digit neighborhood for both the markets. And we're trying to get lower back in that range. And we've been well above that on upper and expect that to continue.

Operator

And your next question comes from Richard Newitter from Leerink Partners.

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

Bob, I was just wondering. On the 7% to 9% lower extremity market rate, my understanding was that your guidance and the expectation to get back to that rate exiting the year was not predicated on any meaningful contribution from kind of the minimally invasive portfolio that you launched at AAOS. Is that true? And if so, should we think that, if that does kind of start to contribute in the back half of the year that there could be faster-than-market growth?

Robert J. Palmisano - *Wright Medical Group N.V. - President, CEO & Executive Director*

No, Rich, that is in our guidance. We can -- as I said, we -- this is a major product launch for us. And getting back to that market growth rate includes in the second -- in Q3 and Q4 a pretty good contribution from minimally invasive surgery.

Lance A. Berry - *Wright Medical Group N.V. - Senior VP & CFO*

Yes, Rich, we talked about the new products in the foot and ankle are in particular were an important part of the recipe to get that growing back like we wanted it to. We highlighted that as an important component previously when we laid out our guidance.

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

Okay. I might've misunderstood. I thought there was a component that you said you did not have to rely on to get better. Maybe it was the productivity and a portion of the lower extremity.

Lance A. Berry - *Wright Medical Group N.V. - Senior VP & CFO*

Yes, I think we talked -- we highlighted the new product contribution this year is considerably more than it's been in the past couple of years. And the new product contribution alone, it pretty much got us to where we needed to be. And we did expect there to be improvement in the salesforce execution, but just highlighting that new product flow was going to be a much bigger contributor this year than it has been in the past couple years, which should really help that business get back on track.

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

Okay. That's helpful. And then a similar kind of question on the upper, just thinking about the guidance, 2x the market rate, is there and can you quantify for us how you kind of think about competition in that guidance figure?

Robert J. Palmisano - *Wright Medical Group N.V. - President, CEO & Executive Director*

Yes, well, we -- in the guidance, we think, again, the market dynamics of going -- of stemless products growing faster, reversed glenoid products growing faster than the market, reverse procedures overtaking anatomic procedures, we did not build in much if anything for competitive entries this year. We haven't seen -- and everything we understand is that they're most likely going to be either later in the year or early next year to be significant. So we have not built in much change in that. We grew over 20% last quarter, 20% this quarter. In another quarter or two, it'll be a trend. But it's a great business. It's growing very, very fast. The biggest thing that we have to do is make sure that we have enough kits to service the surgeries. Our demand is extremely strong and more than we had planned. And getting these kits built and into the field is a timely -- you just can't do it overnight. So that's the biggest hurdle we have is not demand or not competition, is getting these kits into the field.

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

Great. And maybe, Bob, just one last one. Your gross margin here, really impressive, just under 80%. I'm just wondering. Is this kind of where you hoped to get to, or where does it -- where could the outlook go from here? Is there --

---

Robert J. Palmisano - *Wright Medical Group N.V. - President, CEO & Executive Director*

Yes, well, what we said when we did the merger is that the -- we had 3 financial goals. We had -- we wanted to be mid-teens growth. And now we're saying double-digit growth, but close, 20% EBITDA and high 70% margins. That's the kind of the criteria that we laid out. Now our gross margins at just under 80% probably will step back slightly. I don't think they'll step back a lot. But we should be consistently over the period of years ahead in the high 70% area.

Lance A. Berry - *Wright Medical Group N.V. - Senior VP & CFO*

And Rich, our line item guidance for gross margin for this year is in the 79% range. And so obviously, this was toward the higher end of that. And we're not changing our line item guidance for the year. But obviously, it is off to a great start.

Operator

And our next question comes from Jeff Johnson from Baird.

Jeffrey D. Johnson - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Bob, you've talked a little bit about competition in the stemless side. And I think we're hearing the same thing that some of those kits and product launches are probably more in the back half of this year and that. But can you talk about salesforce on the upper extremity side, the stability and expected stability of that salesforce? We have heard some chatter that some of those companies may be looking for experienced shoulder reps and that. So anything you can talk to there and how you plan on maybe defending that side of the business as well.

Robert J. Palmisano - *Wright Medical Group N.V. - President, CEO & Executive Director*

Well, I think if you're an orthopedic shoulder rep, you want to be at Wright Medical. And so we have -- our business has grown. We have a consistent flow of new products. We're very focused on it, where competitors are. It's one of many things they have to worry about. So no, we have not lost any reps. We've lost reps through natural turnover, nothing out of the ordinary. I'll tell you though that their exhaustion might be setting in at some point in time because we're going all the time. I said just before is that the biggest issue we have is not competition or market or anything like that. It's deploying kits. And so we have -- in some areas, we have kits that are turning 7 or 8 times. And that requires an awful lot of scrambling on the part of reps. So hopefully, as we deploy more kits and get to more reasonable turns to meet demand is that that will slow down some. But they're making a great income. They're -- but they are really going full out right now. And I don't think that, knowing our salesforce, is that they would trade that for anything. They would rather be extremely busy with great products and great training and great relationship than being in a much slower-paced environment.

Jeffrey D. Johnson - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Fair enough. That's helpful. And then last, maybe one quick follow-up question just on the balance sheet. I think encouraging to see it shored up here. But if you needed any kind of strategic or growth capital or strategic capital I guess is how I'd think about it, do you have preferences at this point? What would be options out there, or how would you think about that going forward?

Lance A. Berry - *Wright Medical Group N.V. - Senior VP & CFO*

I think there have to really be facts and circumstances, Jeff. We certainly don't have any imminent need for anything at the moment. And it would probably just have to depend on what the asset was and what we need to do partly to get it. Sometimes, we've talked about in the past our stock can be an advantage on some of these companies, these technology-driven companies. They can ride potential upside. That's a factor. We've used a convert market in the past. And then for smaller-sized deals, we've been able to find some incremental capacity just for straight debt. So I don't think there's necessarily one definitive way. It kind of depends on what the asset is and what's the competitive dynamics of the deal that kind of drive the need.

Operator

And our next question comes from Joanne Wuensch from BMO Capital Markets.

Joanne Karen Wuensch - *BMO Capital Markets Equity Research - MD & Research Analyst*

One moment on AUGMENT inject. How do we think about how you're preparing for that FDA approval in terms of manufacturing, marketing materials, training your salesforce and anything else that I'm missing?

Robert J. Palmisano - *Wright Medical Group N.V. - President, CEO & Executive Director*

So we've gone through training with our salesforce. We did that at our national sales meeting. It's not a complex training to go through. The -- so and manufacturing wise is that we have started previously to inventory supply of injectable. The big gating issue is the FDA language in their labeling and surgical technique brochures. And once we get that approved and ready to go, then we'll -- then they'll take a while to get inserted and finalized. But it shouldn't take all that long. So once we're approved, we think we can get up and running in a matter of weeks.

Joanne Karen Wuensch - *BMO Capital Markets Equity Research - MD & Research Analyst*

And how do we think about that market opportunity? The physician at AAOS really spoke well about it. But how do you think about translating that into dollars and cents?

Robert J. Palmisano - *Wright Medical Group N.V. - President, CEO & Executive Director*

Well, a couple things. The -- where we went from what we now call AUGMENT classic, which is the current formulation, to AUGMENT injectable in some international markets, there was about a 30% increase in that doctors were -- the handling characteristics are so far superior. But more importantly is they were able to use it in more different places because of getting into smaller spaces than they could with the current formula. And doctors that were very concerned about time with surgery didn't want to spend time mixing the current formulation. So you increase doctors. You increase usage with AUGMENT inject. Now I'm not saying we're going to get a 30% increase, but that's the history. Secondly is that the doctors that have had it are just kind of really enthusiastic, more -- their -- the intensity and enthusiasm among doctors that use AUGMENT inject versus AUGMENT classic is palatable. It's very, very different.

Operator

And our next question comes from Kaila Krum from William Blair.

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

So first, just to follow up to an earlier question, you did say March was really strong and that you guys saw a return to growth in the core lower extremities business as you exited. So can you just give us any more specific color around that? Did the lower -- the core lower extremities business grow in the low single, mid-single-digit growth range in March? And are you expecting it to ramp from that level, or did it actually reach market growth exiting the quarter? Just any additional detail there would be helpful.

Robert J. Palmisano - *Wright Medical Group N.V. - President, CEO & Executive Director*

Well, just -- I don't have the specifics. Normally, we're not going to give a monthly breakdown. But the way the quarter developed, as I said, January was weak. February was better. And March was strong. And we see that continuing. It's a trajectory I think thing more than anything. And -- but I don't have a percentage growth by month in the quarter, but it was much better, much, much better in March than it was in January and even February.

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

Okay. That's helpful. And then on IMASCAP, can you just talk about how the integration of that business is going? Seems like it should be pretty straightforward, but I guess I'm just curious if you're finding any unexpected or early additive synergies in that business at this point.

Robert J. Palmisano - *Wright Medical Group N.V. - President, CEO & Executive Director*

Nothing unexpected. It's kind of a standalone. It's in a small community in France, right on the English Channel. It's very difficult to get to. So they like it that way. So they don't get a lot of visitors from Wright Medical, I think the way they like it. But they -- we're very much in communication with them. And matter of fact, the General Manager Jean Chaoui will be here next week. We'll have an update with him. We're very anxious to get these additional modules developed that we can move from preplanning into actual surgery. The metric that we most commonly use in terms of BLUEPRINT is the amount of cases saved because that's the predicate really is that you have to save the cases. And we're up to about 20% of all cases are saved now. So that's a real big improvement or real big -- really high -- I can't say an improvement because we're just starting. But we think that's a great trajectory. And we're just really at the beginning of this. This is -- I think that this software and the augmented reality and the artificial intelligence that this is capable of is really going to transform this whole business.

Operator

And that does conclude our question-and-answer session for today's conference. I would now like to turn the conference back over to Bob Palmisano for any closing remarks.

Robert J. Palmisano - *Wright Medical Group N.V. - President, CEO & Executive Director*

Thank you, and thank all of you for joining us today. I want to take just a moment to express my appreciation to our team for their efforts in Q1. I look forward to updating you in our next quarter earnings call. We appreciate your interest and your continued support. This concludes our call.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program. You may all disconnect. Everyone have a wonderful day