OFIX 1Q24 Earnings Call

May 7, 2024

Louisa Smith- Gilmartin Group

Thank you, operator, and good morning, everyone. Welcome to the Orthofix First Quarter 2024 Earnings Call. Joining me on the call today are President and Chief Executive Officer, Massimo Calafiore, and Chief Financial Officer, Julie Andrews.

During this call, we will be making forward-looking statements that involve risks and uncertainties. All statements other than those of historical facts are forward-looking statements, including any earnings guidance we provide and any statements about our plans, beliefs, strategies, expectations, goals, or objectives. Investors are cautioned not to place undue reliance on such forward-looking statements as there is no assurance that the matter contained in such statements will occur. The forward-looking statements we will make on today's call are based on our beliefs and expectations as of today, May 7, 2024.

We do not undertake any obligation to revise or update such forward-looking statements. Some factors that could cause actual results to be materially different from the forward-looking statements made by us on the call include the risk factors disclosed under the heading Risk Factors in our Form 10-Q filed this morning, May 7, 2024, as well as additional SEC filings we make in the future.

In addition, on today's call, we will refer to various non-GAAP financial measures. We believe that in order to properly understand our short-term and long-term financial trends, investors may wish to review these matters as a supplement to the financial measures determined in accordance with U.S. GAAP. Please refer to today's news release announcing our first quarter 2024 results for reconciliations of these non-GAAP financial measures to our U.S. GAAP financial results.

At this point, I will turn the call over to Massimo.

Massimo Calafiore- President and Chief Executive Officer, Orthofix Medical

Thank you, Louisa. And thank you, everyone, for joining us this morning for our first quarter earnings call. I'll spend some time providing insight into our higher-level strategy as well as updates on some key priorities and initiatives before I turn it over to Julie for further detail on our quarterly performance and financial results.

I am pleased to report another strong quarter for Orthofix, driven by healthy business fundamentals and the exceptional operating performance of our teams. We continue to gain momentum and leveraging strategic initiatives to grow Orthofix across all our business segments. Net revenue for the first quarter was $189 million, representing a 7.5% year-over-year increase in constant currency, led primarily by 10% growth across our US businesses. The strength in US performance was driven by 10% growth in BGT, 16% growth in Spine Fixation, and 23% growth in Orthopedics. We are clearly outpacing market growth in all of these segments. We are delivering innovative products and outstanding service while executing to plan and taking advantage of emerging opportunities. I remain very confident in our future and the prospect to deliver value moving forward.

To reiterate some of the 2024 priorities that we laid out in our fourth quarter call, we are diligently focused on 1) profitable growth, 2) emphasizing a synergistic and balanced approach to our portfolio platforms, and 3) strategic innovation. We remain committed to delivering across all three in the near-term and are already seeing pull through in our results.

Our first priority is to grow the business and grow it profitably. Julie will discuss specific metrics later, but I am happy to report that in the first quarter we saw an improvement of more than 200 basis points in our adjusted EBITDA margin as a result of strong top line growth and the realization of synergies. We will sustain this momentum by expanding existing customer and distributor relationships, optimizing our product portfolio and improving our working capital management.

In the first quarter, revenues benefited from continued BGT cross-selling within the Spine Channel. In U.S. Spine Fixation, we saw increases in average price per procedure as we broadened the use of Interbody and Thoracolumbar products across our surgeon customer base as well as through significant contributions from new distributor partnerships. We are penetrating deeper into existing accounts with our procedural solutions while expanding our distribution network.

In addition, we are maximizing the robust portfolio of the combined company by focusing on our higher margin products and rationalizing any overlap. This product life-cycle management will not only reduce costs by simplifying our supply chain but enable us to direct resources and investment toward the expansion of new and innovative product lines. Furthermore, this strategy improves our working capital by lowering the number of products and SKUs we carry.

We are efficiently allocating the recent investments in Spinal Implant instrument sets to our larger, more dedicated distributors, which will improve inventory and instrument utilization. And, finally, we see further opportunities to improve cash flow by focusing on DSO efficiency and accelerating cash collections. As a result of these initiatives, we expect to be cashflow positive in the fourth quarter of 2024.

Moving to our second priority, which is to leverage our technologies and sales channels across all product segments. Our products work together to create a best-in-class offering, each improving the performance of the other and enabling growth through cross selling opportunities. We are seeing traction across our commercial infrastructure with increasing interest in what we are building, allowing us the opportunity to be selective in our choice of distribution partners. Additionally, the team is aligned on driving pull through revenue across spine, orthopedics, biologics and BGT. We are seeing market share gains in complementary areas of the portfolio where our offerings are able to support the

outcomes of the more complex product lines in orthopedics and spine. For example, we just completed the 100,000th implantation of our Strand family of Demineralized Bone Fibers. These strand fibers are designed to enable maximum bone forming capacity and fusion potential. The alignment of BGT, enabling technologies and biologics cross-selling opportunities highlights the complementary nature of our offerings as a whole.

A key part of Orthofix's success and our strong performance to date are the committed employees and leadership teams that we have in place. Since beginning my role at the Company we've made a few changes to certain roles, expanded others, and finalized some key hires that will set us up for the future, with an eye towards efficiently managing our product portfolios. For example, I'd like to highlight the recent promotion of Dr. Beau Standish to Chief Enabling Technologies Officer. In this expanded role, Beau will oversee strategy, development, and implementation of software, and corresponding hardware across all of our product portfolio, reinforcing our commitment to drive synergies throughout the business.

Enabling Technology has been a key differentiator for Orthofix. Our investments in the 7D FLASH Navigation, have established Orthofix as the partner of choice for surgeons seeking innovative, data-driven intraoperative solutions with improved workflow.

With this new role, we will leverage our combined intellectual capital and comprehensive suite of software and hardware products to support both Spine and Orthopedic surgeons throughout the continuum of care. This begins with pre-operative planning using our Orthopedics planning platform OrthoNext, continues with real-time operating room navigation and guidance through 7D FLASH Navigation, and extends to post-operative care with our bone-growth stimulator devices. Our award-winning patient engagement app, Stim onTrack, supports patient compliance and tracks patient reported outcomes. By expanding the capabilities of our existing technology platforms across all of our businesses we will accelerate growth in high value procedures and drive significant gains in market share. These investments in enabling technologies are also consistent with our third priority, a commitment to Orthofix's innovation engine.

We have several promising products in development and a robust pipeline of upcoming launches. We are investing in markets with a higher return potential, especially where Orthofix has the opportunity to establish itself as a leading player or where there remain significant untapped needs.

For example, we are *just* beginning to expand into the US Orthopedics market, which presents incredible growth opportunities given our unique and innovative product lines. Our focus in Orthopedics providing highly specialized solutions for underserved markets is underscored by two recent 510(k) clearances — for the Rodeo Telescopic Intramedullary Nail and for the Fitbone Bone Transport and Lengthening Nail. It is the only commercially available nail capable of both transport and lengthening, and the only bone transport nail available in the US. We will be launching both of these products through limited US market releases in the coming months. These achievements demonstrate our ability to deliver innovative products in the U.S. Orthopedics market and reflect our current focus on strategic innovation across complex limb reconstruction and deformity correction.

In our Spine portfolio we are continuing to validate our MIS anterior lateral portfolio integrating novel access solutions with our differentiated hardware and biologics. This is just one of many procedural

integrations in the works to advance patient care and improve the surgeon experience with state of the art enabling technology in 7D.

Our goal is to be the trusted partner for surgeons in spine and orthopedics, providing solutions for the most complex cases through our unique, complementary product platforms.

All in all, I'm very pleased with our performance during my first quarter on the job. I remain encouraged by the prospects for Orthofix and inspired by a team that is embracing a relentless focus on execution and innovation. As a result of that confidence, we are narrowing our full year 2024 revenue guidance and raising the bottom end of the range by five million. We now expect 2024 revenues to be between $790-795 million, as compared to the prior guidance of $785-795 million and 5% - 7% growth. The merger thesis and the fundamental strategy across spine, orthopedics, biologics and BGT remains compelling. We are growing the company in a measured and strategic manner to reach profitability, and we're creating value for our customers, patients, and shareholders. I truly believe the best is yet to come.

With that, I'll now turn the call over to Julie to review our first quarter financial results.

Julie Andrews- Chief Financial Officer, Orthofix Medical

Thank you, Massimo, and good morning, everyone.

Before I begin, I'd like to remind you to please refer to our press release published earlier today for information regarding our non-GAAP results including our reconciliation of these results to our GAAP results. Additionally, all revenue percentage changes discussed will be on a constant currency year over year basis. As of this quarter we have annualized the impact of the merger and will no longer be referring to proforma growth. In addition, all results of operations that I refer to in my prepared comments will be on a non-GAAP as-adjusted basis.

As Massimo noted, Orthofix had a strong first quarter delivering 7.5% constant currency top line growth and EBITDA margin expansion of approximately 220 basis points. For my commentary, I'll go through each of our business units and review financial results on the quarter as well as provide an update to our guidance for the full year 2024.

Total Company net sales were $188.6 million in the first quarter of 2024, up 7.5 percent over prior year.

Bone Growth Therapies revenue grew 10 percent to $52.5 million in Q1 and marked the fifth consecutive quarter of double-digit growth for the BGT franchise. This growth was driven by above market performance in both the spine and fracture channel. In the Spine market where we hold the number one market share position, we continue to take share with more than 50% of the growth coming from new customer acquisition. In addition, investments in the fracture market sales channel drove 16.8 percent growth in fracture with Accelstim continuing to outperform the market. As a reminder, the fracture market represents an opportunity of more than 200 million dollars and we are just beginning to scratch the surface of our potential in that market.

Global Spinal Implants, Biologics, and Enabling Technologies first quarter revenue was $108.8 million, with year over year growth of 7.2 percent. U.S. Spine fixation revenue grew 16.1 percent, well above market growth rates driven by contributions from new distributor partners where we saw revenue nearly double from Q4 2023 and deeper penetration of existing accounts with increases to the average revenue per procedure. Additionally, in the biologics business we saw a positive impact of new distributor partnerships as well as cross-selling initiatives which drove growth in line with the overall market.

The Global Orthopedics business grew 3.8 percent in the first quarter, led by 22.9 percent growth in the U.S as a result of strong performance across our portfolio, as well as distributor expansion and sales channel investments. The International business declined 2.7% vs prior year due to timing of orders from our stocking distributors. Due to the nature of this business, we expect to see variability from quarter to quarter in the growth rates.

Moving on to some detail below the sales line:

Starting with our Q1 non-GAAP adjusted gross margins, we achieved a 70.3 percent rate for the quarter, a decrease of approximately 40 basis points compared to Q1 2023. This reduction is primarily due to an overlap in vendors as we phased out a legacy partner and moved to a new vendor that will result in cost savings starting in Q2.

Non-GAAP Sales and Marketing expenses were 51.8 percent of net sales for the first quarter, compared to 52.3 percent of net sales for Q1 2023. The decrease as a percent of sales was primarily driven by the realization of cost synergies and a lower effective commission rate due to product mix.

Non-GAAP General and Administrative expenses were 13.7 percent of net sales for Q1 2024 down from 17.8 percent in the same quarter prior year. The decrease as a percent of sales was primarily driven by the impact of cost synergies and a reduction in stock-based compensation.

Non-GAAP R&D expenses were 10.2 percent for the quarter compared to 10.5 percent for the prior year quarter. The decrease as a percent of sales was driven by a reduction in product development spend due to project rationalization partially offset by increased clinical spending related to EU MDR costs which are no longer adjusted from operating results and the M6 two-level study.

Below the operating income line, interest expense and other was $4.5 million for the quarter.

Altogether, this resulted in Non-GAAP adjusted EBITDA of $7.7 million or 4.1 percent of net sales for the quarter, a 220 basis point expansion over Q1 2023 due to the capture of merger related synergies and driving leverage on sales growth. This represented a 34 percent drop-through on incremental revenue dollars. We remain encouraged by these results as we are seeing the impact of merger-related synergies and our ability to drive leverage on sales growth materialize.

From a cash standpoint, our total cash balance including restricted cash at the end of Q1 was approximately $29 million. During the first quarter of 2024, we exercised our borrowing rights under our four-year $150 million financing arrangement to the delayed draw term loan of $25 million, which had an end of March 2024 expiration date, and repaid the outstanding revolver of $15 million. This brings the total borrowings to $125 million. Our free cash flow usage was $29 million in the quarter

primarily as a result of annual incentive and one-time merger related retention payments. Q1 will be the highest quarter of cash burn for the year. As Massimo mentioned we are focusing on improving our working capital management specifically our inventory and instrument utilization and DSO efficiency. With these efforts as well as continued execution of merger-related costs synergies, we expect to be cash flow positive in Q4 2024.

Overall, we are pleased with our first quarter results, and we continue to be confident in our ability to drive profitable revenue growth moving forward.

Moving on to 2024 full year guidance**…** As Massimo stated, we are narrowing our guidance for full year net sales to range between $790 and $795 million, representing implied growth of 6 to 7 percent year-over-year on a constant currency basis. This is in comparison to the guidance issued during our fourth quarter call of $785-$795 million, a 5-7% growth. Please note, our expectations are based on current foreign exchange rates and do not account for rate changes that may occur throughout 2024.

Our outlook for full year 2024 non-GAAP adjusted EBITDA remains at $62 to $67 million and finally, we expect to be cash flow positive in the fourth quarter of 2024.

While we do not provide quarterly guidance, I will give some directional commentary on the expected cadence of our business to assist you in modeling our quarterly performance. These comments remain in line with the directional remarks provided on our fourth quarter call in March.

We expect Q2 revenue to be slightly below our full year growth guidance range due to timing of stocking orders in 2023. Additionally, we expect Q3 to reflect the highest year-over-year growth due to disruption in the prior year as we closed the quarter and the impact of one additional selling day in 2024 vs 2023. This extra day results in approximately 1.5% of additional growth for the quarter.

For gross margin, we continue to expect 2024 full year gross margin to be in the 71 percent range, in line with 2023.

We also expect operating expenses to decrease approximately 200 to 300 basis points through leverage on incremental sales and additional cost synergies.

To assist you with modeling EBITDA, we reiterate our outlook for depreciation expense, which for the full-year 2024 is in the range of approximately $36 million to $37 million as compared to $33 million in 2023. Stock-based compensation expense is anticipated to be in the range of $30 million to $32 million.

Below the operating income line….

Our expectation for interest and other is approximately $5 million per quarter.

We expect adjusted EBITDA margin improvement of 200 basis points for the full year to be fairly consistent over the course of the year, with margin expansion in the first half of the year to be slightly higher over prior year as we annualize synergies.

And finally, for cash we still anticipate an improvement in net cash outflows in Q2 relative to Q1 due to the payment of the annual bonus and merger related costs that occurred in the first quarter. The second half of the year will progress toward breakeven with positive cash flow for the fourth quarter as we ramp up revenue, leverage our fixed expense base, and improve inventory and DSO efficiencies.

I'll now turn the call over to Massimo for some closing comments.

Massimo Calafiore- President and Chief Executive Officer, Orthofix Medical

I'll close today's call by emphasizing my confidence in the business and reiterating my enthusiasm to be a part of the Orthofix team. We have solid fundamentals, exceptional employees, and a best-in-class portfolio that is delivering above market performance. Throughout 2024 we will keep delivering on our commitments to patients, customers, and shareholders, driving the Company to new heights. Before we sign off, I'd also like to thank all of our employees worldwide for their dedication to Orthofix and its mission- I'm very excited for the next chapter ahead of us.

At this point, we will open the line for questions.

Q&A

Operator: Your first question comes from the line of Mathew Blackman of Stifel. Your line is open.

Mathew Blackman, Analyst STIFEL: Good morning, everybody. Can you hear me okay?

Massimo Calafiore: Yes.

Julie Andrews: Yes. Hi, Matt.

Mathew Blackman, Analyst STIFEL: Great. Hello. Maybe the first question, and I hate the nitpick here, but, guidance for the year is up about $2 million to $3 million midpoint to midpoint versus the $4 million to $5 million in 1Q, I appreciate it's early in the year. I sense conservatism. But you want to make sure you're not seeing anything different here in 2Q. That maybe has tempered your momentum.

Julie Andrews: Yes. No, we wouldn't. We're not seeing anything that would temper our momentum were, again, it's early in the year. We want a new management team in place, and we are confident in what we're delivering but nothing that's tempering our enthusiasm.

Mathew Blackman, Analyst STIFEL: Great. That's what I figured. And then just maybe a housekeeping question. Did you have one fewer day selling day in the first quarter versus 2023? Some of your peers have. So I'm just curious about your calendar.

Julie Andrews: No.

Mathew Blackman, Analyst STIFEL: No. Okay.

Julie Andrews: Yes.

Mathew Blackman, Analyst STIFEL: Okay. And then I guess my last question, and, Julie, you sort of alluded to it. I was hoping maybe get some firmer numbers, but you gave a great metric in the fourth quarter that 8% of sales were from new distributors. You mentioned that continued. Any chance you can update that number similar to last quarter higher. And I appreciate you may not have this at hand, but also, is there any way to give us any sort of same-store sales kind of growth number for your accounts? And I'll leave it at that. Thank you.

Julie Andrews: Okay. I'll say in the revenue from new distributors, I said in the prepared remarks that it nearly doubled. So you can interpret that from the 8% to nearly doubling. And then I don't have same-store sales at the ready in front of me. But we will think about really, if we want to release that or not. Thank you.

Mathew Blackman, Analyst STIFEL: Yes, fair enough. Thanks so much.

Operator: Your next question comes from a line of Ryan Zimmerman of BTIG. Your line is open.

Ryan Zimmerman, Analyst BTIG: Hi. Good morning, guys. This is Izzy on for Ryan. So just first off on the gross margins, it looks like you guys came in line with our estimates this quarter. We were just wondering what you could see that could drive them higher over time?

Julie Andrews: So yes, so over, I mean this year we've said that our margins would be 71% in line with last year. I think as we look into the future, we haven't issued long range guidance on it, but we do see opportunity in the gross margin line. I think, there are synergies with supplier rationalization, leveraging our footprint and those types of things that we're working on.

Ryan Zimmerman, Analyst BTIG: Great. Thank you. And then next on the bone STIM, it looks like you guys are seeing some pretty strong growth here. Just wondering what you can do to maintain this growth in a market that's maybe growing not as fast.

Massimo Calafiore: Yes. This is an excellent question. Look, we see for the foreseeable future, great potential. Just given that from what we said in our remarks. We are leveraging as much as we can right now all of the new surgeons coming from the SeaSpine acquisition. So I said, it's true that the market grows at market rates, but if you confine the business in our domain, we see strong potential asset for the next few quarters. So we will try to maximize this potential as much as we can.

Ryan Zimmerman, Analyst BTIG: Great. Thanks for taking the question.

Operator: Your next question comes from line of Jason Wittes of ROTH MKM. Your line is open.

Jason Wittes, Analyst ROTH MKM: Hi, thanks for taking the questions. Just on the growth rates we saw this quarter especially. I mean you kind of mentioned for global orthopedics, it's going to vary. The spine growth has been pretty nice. Is that something we expect to continue for the rest of the year, or could you comment on sort of what the trends are for the remaining other businesses.

Massimo Calafiore: Yes. Look, we feel pretty confident about the growth rate that we are achieving right now. As we said earlier, we are clearly identified couple of growth drivers for us. One, we are getting a lot of interest from new distributor and new surgeons. The amount of inbound calls that are coming has been pretty remarkable for us. And all of this allows us to really pick and choose the right partner. Because remember, we are fully focused on profitable growth so and we can achieve this if we get the right partners. On the same token, with our investment in innovation, we are seeing a further utilization of our product. So a very healthy increase on revenue per case. So all of this to say that we see a very strong business fundamental for the foreseeable future.

Jason Wittes, Analyst ROTH MKM: Okay. Thank you. Sorry to interrupt. And then you mentioned you should go cash flow positive in Q4. I assume that's sustainable. And going forward, the quarters will be cash flow positive from there on, or will seasonality impact that or sort of what's the outlook for cash flow generation?

Julie Andrews: Yes. We haven't issued formal guidance on that for 2025 and we'll do so later this year, but, yes.

Jason Wittes, Analyst ROTH MKM: Okay. I'll jump back in queue. Thank you.

Julie Andrews: Sure. Thanks, Jason.

Operator: Your next question comes from line of Jeff Cohen of Ladenburg Thalmann. Your line is open.

Jeff Cohen, Analyst Ladenburg Thalmann: Hi, Massimo and Julie, how are you?

Julie Andrews: Good, Jeff, how are you?

Jeff Cohen, Analyst Ladenburg Thalmann: Just fine. So I wondered if you could talk about AccelSTIM a bit and fresh fractures and talk a little bit about some of the channels. And I did hear you call out the fracture market and some of those channels, some of those docs. And are you still focused on surgeons? Is there some focus that's on pain docs as well? Thank you.

Massimo Calafiore: I know right now I think that we are keep leveraging our network on the surgeon side. So at the end, that we have two products that are helping us to address the continuum of radial fracture (inaudible) and malunion. So we are keep driving our product portfolio using existing distributors. Plus try to find synergies with the distributor that are working on the orthopedic side. So our market is defined right now on the surgeon piece.

Jeff Cohen, Analyst Ladenburg Thalmann: Okay. Got it. And then could you talk a little bit about the larger, more dedicated distributors as far as aggregate numbers, do you anticipate over the balance this year that the actual number of distributors will decrease? And then could you give us a sense of feet on the ground? Thank you.

Massimo Calafiore: Yes. I don't think that we give the specific detail about, like the amount, distributor and like in general, what I can tell you is that on the positive side, we are seeing that all our top distributors are keep increasing their loyalty to us. So I think that what we're seeing, everything is shifting to have, let's say, given the depth of our portfolio, especially in spine, our top distributor are becoming exclusive to us. So and I think this one is going to keep driving, is going to help us to drive compliance moving forward and focus with our products. So as I said, we don't give a specific number, but what I can tell you that directionally, the quality of revenue that we are seeing is pretty high right now.

Jeff Cohen, Analyst Ladenburg Thalmann: Okay, perfect. Thanks for taking our questions.