



Orthofix Medical

Q2 2022 Earnings Call

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CORPORATE PARTICIPANTS

Alexa Huerta, *Senior Director of Investor Relations*

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Doug Rice, *Chief Financial Officer*

CONFERENCE CALL PARTICIPANTS

Mathew Blackman, *Stifel*

Jeffrey Cohen, *Ladenburg*

Jim Sidoti, *Sidoti and Company*

PRESENTATION

Operator

Hello, and a warm welcome to Orthofix Medical's Q2 2022 Earnings Call.

I now have the pleasure of handing it over to our host, Alexa Huerta, Senior Director of Investor Relations, to begin.

Alexa, over to you.

Alexa Huerta

Thank you, Operator, and good morning, everyone. Welcome to the Orthofix Second Quarter 2022 Earnings Call. Joining me on the call today are our President and Chief Executive Officer, Jon Serbousek, and Chief Financial Officer Doug Rice.

I'll start with a Safe Harbor statement, and then pass it over to Jon.

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, August 5, 2022. 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 includes the risk factors disclosed under the heading Risk Factors in our form 10-K for the year ended December 31, 2021, and form 10-Q for the quarter ended June 30, 2022, filed this morning, August 5, 2022, as well as additional SEC filings we'll make in the future. If you need copies of these documents, please contact my office at Orthofix in Lewisville, Texas.

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 press release announcing our second quarter 2022 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 Jon.

Jon Serbousek

Thank you, Alexa.

Welcome, everyone, and thank you for joining our Second Quarter 2022 Results Conference Call. On today's call, I'll provide an update of our second quarter performance and review progress towards our strategic initiatives before handing the call over to Doug who'll provide our financial updates. I'll close the call with our perspectives on the balance of 2022 before opening line for questions.

Starting with our second quarter performance, total revenue in the quarter was \$118.1 million and was flat year over year on a constant currency basis. As a result of our commercial channel investments and new product offerings, we delivered solid execution across our spine business and achieving strong performance in our global orthopedics business. These positive results were partially offset by macro headwinds, which had greater than anticipated effects on our business.

In particular, we continue to see slower than expected rebound in elective complex procedure volumes due to ongoing hospital staffing issues, as well as patient reluctance to seek selective procedures in select areas, which impacted our BGT, spinal implants and biologics businesses. Reported revenue for the quarter was materially impacted by the strength of the U.S. dollar relative to our other currencies in which we transact negatively impacting reported revenue by approximately \$2.7 million.

Turning to the performance of our two business units, I will comment first on the spine, followed by orthopedics. Starting with bone growth therapies, or BGT, sales for the quarter were \$48 million, down 4% on a reported basis and constant currency basis compared to second quarter of 2021. The decrease in the quarter was largely a result of a reduction in complex procedures, which generate a relatively large portion of our spine BGT prescriptions, continued staffing issues, and patient caution to seek elective surgeries.

On a positive note, we continue to capture market share with PhysioStim and are seeing early commercial traction of the AccelStim. These share gains and sales tractions reflect investments we've made in our fracture management channel, which calls primarily on orthopedic and pediatric communities to treat fresh and nonunion fractures.

Moving to our spinal implants, which includes both spine fixation and motion preservation. Revenue was down 6% on a reported basis and down 5% on a constant currency basis, as compared to the second quarter of 2021. The decline was due in part to lower than expected complex cases volumes in the U.S., as well as global competitive headwinds in motion preservation. We continue our positive view of the disc replacement market, and the leading-edge technology that M6-C artificial disc provides with its demonstrated clinical outcomes.

Turning to our biologic portfolio, revenue was flat on reported and constant currency basis compared to 2021. During the quarter, we saw positive trends from new product introductions such as fiberFUSE, and from new distributors added in the last 12 months. These trends help offset the macro headwinds, which negatively impacted hospitals' abilities to perform the complex selective procedures that often require our biologic solutions.

Moving on to global orthopedics business, sales were up 2% on a reported basis and 11% on a constant currency basis over 2021. This growth was primarily a result of the strength in the international geographies, driven by the benefits from investments we've made in our sales organization, as well as revenue from international stocking distributors. In the U.S., we have started to see positive benefits from the new sales leadership team put in place over the last 12 months. Both markets are also starting to benefit from our recent product introductions of TrueLok EVO and Galaxy Gemini.

Now moving on to our strategic initiatives. Let's start with the product innovation and differentiation. Since January of 2020, we have launched 28 spine and orthopedic products. Starting with BGT, in May, we received FDA PMA approval for our AccelStim bone healing therapy. AccelStim uses LIPUS or ultrasound technology for the healing of both fresh and nonunion fractures. We started the initial limited U.S. market launch during the second quarter, which included conducting sales force training and initial contracting with our payers. We are pleased to see a high rate of physician adoption from our early training and education initiatives, and we are expecting more meaningful revenue contribution as we move towards the end of 2022 and into 2023, and beyond.

Moving to biologics. During the quarter, we achieved the first clinical implantation of Virtuos, our advanced first-of-its-kind shelf-stable complete autograft substitute. Virtuos was developed as part of our strategic partnership with MTF Biologics, who prepares this complete autograft bone substitute through a proprietary process that preserves all biologic components necessary for bone healing within the graft. It is provided in a room temperature ready-to-use multiple grouts. Virtuos offers significant logistical and cost-saving advantages to hospitals with improved shipping, storage, operating room efficiency, due in part to its environmentally friendly packaging.

Surgeons involved in the exclusive launch of Virtuos have provided favorable feedback, and we look forward to broader commercialization later in the year. I'll comment later in the call on an exciting announcement we made earlier this week on our strategic partnership with CGBio for recombinant bone morphogenic protein or BMP-2 product.

Turning to new products and orthopedics. We partnered with Lima Orthopedics in the U.S. to create a solution for patients with hip dysplasia or abnormalities of the hip that lead to leg length discrepancy. This novel hip digitalization (phon) procedure solution using our FITBONE intramedullary limb-lengthening technology reflects the strength and versatility of the FITBONE platform and patented portfolio, and will be available through the FDA compassionate use exemption.

Turning to our second initiative. The ongoing development of our commercial channel to expand patient and surgeon access to our products worldwide. In Q2, our U.S. strategic channel partners continue to see growth over the prior year. As you recall, our channel partners include distributors that carry multiple Orthofix product categories, such as hardware and biologics.

Most of our channel investment in the quarter was focused on adding U.S. direct reps in BGT to support the launch of AccelStim, as well as growing our orthopedics commercial infrastructure. Both investment areas are important for the future growth, and we are pleased with the progress we're making here.

Our internal team worked hard during the quarter to bring the launch of two significant new products on a limited basis in BGT and biologics. With these launches associated with physician education and sales training, we put ourselves in a great position for success as the macro environment improves, and the volume of elective procedures return to historical trends.

Now, I'll turn the call over to Doug to review our financial performance.

Doug.

Doug Rice

Thanks, Jon, and good morning, everyone.

As many of the financial measures covered in today's call are on a non-GAAP basis, please refer to today's earnings release for further information regarding our non-GAAP reconciliations and disclosures.

Starting with revenue, as Jon noted earlier, total net sales in the quarter were \$118.1 million, or flat at a constant currency, as expected when compared to the second quarter of 2021. In the U.S., total net sales were \$93 million, or 79% of total revenue, down approximately 3% year over year. The primary drivers were reductions in complex procedures, consistent with many in our industry this year, and other macro and competitive headwinds that Jon covered earlier.

International total net sales of \$25 million for the quarter were up 7% in constant currency over the second quarter of 2021 as a result of the recent sales force investments in orthopedics, and sales to international stocking distributors.

GAAP gross margin in the second quarter of 2022 was 73% compared to 77% in the prior year period, due primarily to changes in our sales mix, as well as increased inventory reserve expenses related to set builds for an expanding sales force, and increased safety stock requirements driven by the risk of global supply chain disruption. For the Full Year 2022, we expect GAAP gross margin to be approximately 74% to 75%, which implies an average rate of 75% to 76% in the second half of the year. GAAP sales and marketing expenses in the second quarter were 51% of net sales, up from 47% in the second quarter of 2021.

This increase reflects our investments in direct reps and sales management, and orthopedics, and BGT as well as additional training and marketing expenses related to the AccelStim launch, which will continue into the third quarter. These were offset somewhat by the lower commissions on orders from international stocking distributors. For the Full Year 2022, we still expect GAAP sales and marketing expenses to be in the range of 49% to 50% of net sales.

GAAP G&A expenses in the second quarter were 13% in net sales, down from 15% in the prior year period. The decrease reflects lower legal and professional fees, as well as lower employee expenses.

GAAP R&D expenses for the second quarter stayed flat at 11% of net sales compared to the prior year period. Our focus on innovation and differentiation has increased year over year and new product development expenses, which are offset this quarter by larger development milestone payment made in the second quarter of 2021. We now expect Full Year 2022 GAAP R&D expense to be approximately 11% of net sales, including an impact of about 200 basis points related directly to our EU MDR implementation efforts, for which we adjust within our non-GAAP financial metrics.

Adjusted EBITDA margin in the second quarter decreased to 10% of net sales compared to 15% in the second quarter of 2021, driven by increased COGS, as well as investments in sales management, direct sales reps, and the launch of AccelStim. We continue to expect our Adjusted EBITDA margin for the Full Year 2022 to be approximately 12% of total net sales as we continue to profitably invest in growth. We expect our Adjusted EBITDA margin to increase sequentially in the back half of 2022.

To GAAP acquisition related measurement expense, year-over-year decrease of \$9.6 million primarily reflects a second quarter of 2022 non-cash credit related to the change in the fair value of the spinal kinetics contingent revenue milestone payment liability. We continue to believe in the growth of the M6-C and the cervical disc replacement market; but based on the current operating environment, the lowered

fair value of the underlying liability reflects the anticipated achievement of the remaining revenue-based milestone beyond the contractual measurement end date of April 30, 2023.

Now, turning to tax. We had GAAP income tax expense of \$600,000, or 18% of income before income taxes in the quarter, as compared to a GAAP income tax expense of \$2 million, or 48% of income before income taxes in the same period of 2021. The tax rate in both periods was driven by timing of earnings, as well as GAAP losses without a corresponding tax benefit.

For the second quarter, we reported GAAP EPS of \$0.12, which stayed flat compared to the second quarter of 2021. After adjusting for certain items and when normalizing for tax using our non-GAAP long-term effective tax rate at 28%, Adjusted EPS for the second quarter was \$0.08 as compared to an Adjusted EPS of \$0.32 in the second quarter of 2021.

Regarding cash, our liquidity position remains strong with \$60 million at the end of the second quarter compared to \$88 million dollars at the end of the fourth quarter of 2021. The decrease is primarily related to the \$14 million of increased net inventory, as I mentioned, and the \$2 million final contractual payments made to the FITBONE seller.

Capital expenditures were approximately \$6 million in the quarter compared to \$5 million in the prior year period. The increase was primarily due to investments in operations, the expansion of our manufacturing capabilities, as well as an improved Customer Training and Experience Center for our partners at our headquarters in Lewisville, Texas. We still expect capital expenditures to be in the \$25 million to \$27 million range for 2022.

Now, shifting to guidance for the Full Year 2022. We now expect reported revenue to be in the range of \$455 million to \$465 million, which utilizing current FX rates represents flat to 2% growth at constant currency. This revenue guidance reflects a roughly \$10 million, or 2%, anticipated headwind to our top-line for the full year at reported rates due to the strength in the U.S. dollar compared to the 2021 FX rates.

From a macro perspective, we continue to expect an overhang through the end of the year, and into 2023, related to hospital staffing issues and patient reluctance to seek elective surgery. Key products like AccelStim and Virtuos will gain momentum, but we do not expect to see significant contributions to revenue from these new products until 2023. Reflecting on our quarterly revenue cadence in the back half of this year, we anticipate that our third quarter revenue will reflect typical seasonality with a 3% to 5% decrease in procedure volumes sequentially versus the second quarter of 2022, as well as the increased FX headwinds from the strength in U.S. dollar versus the second quarter of 2022.

For the Full Year 2022, we now expect our Adjusted EBITDA will be in the range of \$53 million to \$57 million, or approximately 12% of revenue, and our Adjusted earnings per share will be between \$0.45 and \$0.55. These ranges reflect the \$3 million FX headwind to our top line due to the strength in U.S. dollar since the May earnings call, inflation uncertainties, our continued investment and delivering a robust pipeline of differentiated products, and expansion of our commercial channel to accelerate our growth trajectory.

I would now like to turn the call back over to Jon.

Jon Serbousek

Thanks, Doug.

Looking to the back half of 2022, we are focused on solidifying ourselves as a leader in the regenerative healing technologies in the spine and orthopedic space, while also delivering sustainable profitable growth driven by innovation and differentiation within our product portfolio, as well as optimizing our commercial channel. We'll also continue to be focused on working capital management while growing our

top-line sales. In the near term, we'll continue to advance several of our growth drivers, including the M6-C artificial cervical disc, the FITBONE limb-lengthening system, the AccelStim bone growth stimulation device, and our expanded biologics portfolio.

I'd like to provide a quick update on each of these growth drivers. Starting with the M6-C artificial cervical disc. We have one of the leading cervical disc platforms in the market, with over 60,000 global M6-C discs implanted over 16-plus years. We are pleased with the continued strength of the clinical evidence for this technology. In the U.S., we are progressing the M6-C two-level clinical trial, which remains on track. We are also in the middle of a global real-world evidence study that will access over 3,000 patients to expand and further reinforce our body of M6-C clinical evidence. We also recently analyzed our internal records of over 16 years and 60,000 discs implanted with long-term survivorship analysis, which projects a global cumulative survivorship of 99% at 10 years. We believe it's important to invest in these clinical studies to ensure surgeons have the best available information to inform their implant decisions with their patients.

Turning to the FITBONE limb-lengthening system, it was added to the list of reimbursable products and services for the French Ministry of Health and Preventions. This makes FITBONE the only intramedullary lengthening nail included on the French Ministry list, and thus, the only reimbursable lengthening nail by the Public Health System in France. As a result of the French reimbursement decision, and the Lima partnership we mentioned earlier, we expect to see marginal increase in FITBONE revenue growth in the second half of 2022, and continued growth during 2023, with a planned U.S. launch of the FITBONE trochanteric nail as well.

As mentioned earlier, our AccelStim ultrasound product in BGT for the healing of bone with fresh fracture and nonunion fractures had a limited launch in the second quarter. Although the sales force training will not be complete until the end of the third quarter 2022 and contract with payers is still ramping up, we expect to see more meaningful revenue contribution in 2023 and beyond.

Let's move to our biologics near-term growth drivers. The Virtuos allograft, a first-of-its-kind shelf-stable complete autograft substitute for spine and orthopedic suit procedures, recently had the first patient implant and limited market release. We anticipate increasing surgeon demand as we continue to commercialize throughout the rest of 2022 and into 2023. In addition to Virtuos, we are very excited to launch Legacy Demineralized Bone Matrix in partnership with MTF Biologics in the coming weeks. Legacy, a feature-rich cost-effective new option for surgeons, is an aseptically process prehydrated and flowable DBM putty that is ready to use out of the syringe.

On July 30, 2022, the Company entered into a strategic licensing and distribution agreement with CGBio, a developer of innovative synthetic bone grafts. The agreement grants Orthofix an exclusive right to conduct pre-clinical and clinical studies, commercialize, promote, market and sell the Novosis recombinant human bone morphogenic protein-2, or rhBMP-2, bone graft materials, and other future tissue regenerative solutions, in the U.S. and Canada. Novosis is the next evolution of the bone growth factor technology market. It has been commercially available internationally and implanted in over 50,000 patients, and presents a potential compelling alternative to the single product available in the over \$650 million current U.S. market.

Our deeply experienced biologics clinical and management teams are excited to work to bring an alternative BMP-2 solution to the market. With Virtuos and Legacy added to our biologics offering, Orthofix now commands one of the industry's most complete biologics portfolios for spine in orthopedics, giving surgeons the ability to select the best options to meet their procedural and patient needs. Bone growth factor is the largest growing segment in the biologics market. Our partnership with CGBio represents an important new future strategic market opportunity.

To wrap things up, I would like to touch on our future plans and direction. Our strategic plan and goals remain the same. We are steadfast on our transformational path, focusing on executing against our short-term goals and driving our long-term high single-digit profitability growth and EBITDA margin expansion strategy. We've made significant progress already, and expect to continue to do so in the second half of

this year and beyond, supported by our clean balance sheet, and strong cash flow, which have allowed us to internally fund our growth activities.

We are excited about our key new product introductions in 2022, which we expect to contribute meaningfully in 2023 and beyond to our portfolio performance. Lastly, as previously demonstrated with our successful disciplined approach, we will continue our inorganic business development and see a great deal of opportunity with our balance sheet capacity to execute in the current macro environment.

On a closing note, I'm extremely proud of our global team members, as they have shown flexibility, resolve and focus as we've navigated this unique and challenging business environment. I'm thankful for their commitment to our mission and have confidence in our strategic plan and future.

Thank you for your time today, and your continued interest in the success of Orthofix.

Operator, will you please open the lines for questions?

Operator

Of course, thank you. We will be taking our first question today from Mathew Blackman of Stifel.

Matt, over to you.

Mathew Blackman

Good morning, everybody. Thanks for taking my questions. I have a couple for Jon, and then one for Doug.

Jon, everyone has called out similar headwinds in 2Q and into 2H '22, but the magnitude you're implying for the back of the year is more intense. How would you explain that? Is it that you have an outsize complex procedure mix relative to peers? Just any thoughts on your business relative to what we're hearing from others?

Doug Rice

Yes, Matt. Thank you.

Regarding the procedure base, we've highlighted as well, as far as complex procedures that we rely on for our BGT business, because that's where they're utilized and postoperatively. As well as the biologics, many of our high-potential or high-potency biologics are used in those complex procedures. As we look at uncertainty in that area based on the hospital feedback, we get the flow of those patients and some of the patient will have some reluctance in this time for those complex procedures. We see that as a headwind. Additionally, in that area, as far as the headwind and the competitive environment on intersects as well, that we're looking at motion preservation. We see that as another issue that we're going to deal with.

Mathew Blackman

Maybe to that point, Jon, just maybe talk a little bit more about the competitive environment. I know you had some comments in the prepared remarks, but is that business still growing year over year or quarter over quarter? I appreciate you're touting clinical data and generating more clinical data. But how do you stem these share losses? Is there a timeframe where you think we could maybe stabilize that business and return it to maybe more typical type growth rates? Thanks. Then a follow-up for Doug. Apologies.

Jon Serbousek

Matt, thank you. The space has become more competitive, obviously, there's a new entrant into in our marketplace, as well as reinforcement and some of the other products that are out there being promoted heavily. However, we see that as an opportunity to expand the market, and that's why we have absolute conviction in M6-C, as far as the leading technology in the space, and then clinical data will drive that as well as the performance of the technology.

We're robust on the—feel robust on this artificial disc cervical market, and we're going to continue to invest in that, and we'll level off and we get back to growth. I mean, the fact is, we are growing, but we're not growing at the pace we once were. So that's reality where we're at. We're looking forward to performance in the future.

Mathew Blackman

All right. Then, Doug, can you bridge us from the old FX guidance on the to -line to the new guidance? I think, it sounds like sort of the downdraft is probably concentrated in the U.S. hardware, biologics and BGT business, is that the right way to think about where the back half of the year gets more challenging?

Doug Rice

Yes, good question, Matt.

We see, like everybody, the continued strengthening of the U.S. dollar, we've got about 22% of our top line is from the U.S. and is heavily exposed to that Euro-dollar rate, so that strengthened. Our results to be impacted 2% to 3%. I think since the last time we guided in May, you've seen further degradation from what we expected by about \$3 million, but overall, for the year, sort of in the 2.5% to 3% range.

Mathew Blackman

Sorry, I was asking you about the ex-FX, the bridge from your old ex-currency guidance to the new ex-FX guidance, so taking out the currency.

Doug Rice

Yes, it's probably another 0.5% to 1%, about another \$3 million from when we guided it last May.

Mathew Blackman

Again, that's going to be isolated probably is here in the commentary with the complex headwinds to the U.S. hardware, biologics and BGT business. I guess, the implied question there is you still expect sort of strong growth in the orthopedics—the global orthopedics franchise?

Doug Rice

Yes, the remainder of the guidance shift, that really is sort of FX on one side related to our U.S. exposure. But the rest of it is, like Jon just alluded to, and as our comments in the script, summarized our exposure to complex procedures, both in our spine hardware as well as our BGT and biologics product categories. Then we've seen macro headwinds with hospital staffing issues, inflation, patient caution to come back into a clinical environment across the board in really all geographies.

Mathew Blackman

All right. Thanks so much.

Operator

Thank you for your question.

We'll move to our next question, which comes from the line of Jeffrey Cohen of Ladenburg.

Jeffrey, please go ahead.

Jeffrey Cohen

Hi, Jon and Doug. How are you?

Jon Serbousek

Good, Jeff. Thanks

Doug Rice

Good morning, Jeff.

Jeffrey Cohen

Couple of questions from our end. I guess, firstly, can you talk a little more about hospital staffing and the cadence on the back half, as you did call out a relatively strong global business for the quarter? Are you seeing the same issues there? Do you expect that to pull through into Q3 and Q4, as well, similarly to the U.S. business?

Jon Serbousek

Jeff, from our channel checks in the hospital staffing, it's all staffing. It's just not nurses and doctors, and comes down to that they're projecting to the last for another three, four quarters on the short side. That's in the hospital. We see migration of cases to the ASC for the smaller, so that there are easier and more straightforward cases. There's something easier—there's more straightforward cases. We see that on the OES standpoint, it's country by country, region by region. It's without going to each individual activity. Some markets are back and being more robust, and there's some that are still compressed. But also, from on a global basis, we see that there's still an impact out there. We don't even address COVID anymore in that conversation; but doctors get sick, patients get sick. We don't even look at that in regard. We just put that into the hospital headwinds.

Jeffrey Cohen

Okay, got it. Then second for us. Can you take us through a little more about AccelStim and its launch and some of the initial users, and what you're finding out there? Are the users for AccelStim all current users of PhysioStim product, or are you finding that you're picking up some interest elsewhere outside of PhysioStim?

Jon Serbousek

Yes, we're that AccelStim is; the product that has been well accepted in the marketplace.

We're getting positive feedback from the clinicians, and those are new clinicians. We're getting a good lift into pediatric area as well as the orthopedic area on fresh fracture. We've been there for quite some time with our PhysioStim in the nonunion area. So those customers are using PhysioStim and we're moving towards new customers in AccelStim.

Jeffrey Cohen

Okay, got it. Then lastly, I had a question for Doug on the Capex guide: was at \$25 million to \$27 million I heard earlier?

Doug Rice

That's right. That's consistent with where we were last quarter, as well.

Jeffrey Cohen

Perfect. Okay, that does it for us. Thanks for taking the questions.

Operator

Thank you, Jeffrey.

Doug Rice

Thank you, Jeff.

Operator

We'll be taking our next question today from Jim Sidoti of Sidoti and Company.

Jim, over to you.

Jim Sidoti

Good morning, and thanks for taking the questions.

It feels like your strategy to get the products out is working. There's the expanded sales force is working. But that's being overshadowed by the pressure on procedures right now. You want to look into the crystal ball and give us any kind of indication when you think procedures get back to the pre-COVID level?

Jon Serbousek

Jim, this is Jon. Thanks for the question.

Part of the discussion on procedure return, I mean, we see procedures returned, and we're returning more of the ASCs; but in the complex factors, the patients have some reluctance, and some of its financial economic from our channel check, but also, hospitals have less of the capacity to flow through. They're all open. They're all moving forward. But the fact is, they're doing fewer cases, and they also have to prioritize which service line they want to prioritize cases into. They're working through this activity, both on the macro headwinds from both economic standpoints, from the inflationary pressures, but also for how patient behavior occurs.

We know that these complex patients do not get better on their own. They are out there. They will come back into the service—into the hospitals to be treated. These are hospital-based cases, and the challenge that we see in our portfolio is that we have BGT and biologics, and to some extent our spine business as well, that gets impacted by those complex cases. We're over proportioned in that area, and that's why, I think, we're seeing some—suggesting some of the results that we're seeing.

Jim Sidoti

You talked a little bit about inorganic opportunities. Would you consider maybe getting some devices used in the ASCs, some kind of hedge against the pressure on these more complex devices, or do you think you're going to stay in the hospital for most of your products?

Jon Serbousek

Thanks, Jim. We have an initiative to go into ASCs. We have not only our M6-C disk, those in the hospital. We've made an investment in Neo Medical, in the single-use sterile products. That's part of our initiative in the ASC, not only in the lower back, but also into cervical. As we managed to speak these competitive headwinds, and we put together an ASC package, we believe we're going to have a strong position with ASCs going forward. That is part of the strategy to deal with just this issue we're talking about today and complex procedures, and get a balanced portfolio across all the service line areas.

Jim Sidoti

All right. Then one for Doug. Inventory, like you're very similar to other companies that I cover, you've increased inventory levels to kind of hedge against some of these supply chain issues. I think it's up about \$15 million for the year. Do you think this is a good level for you, or do you think you'll continue to increase inventory? Do you think you'll get back to free cash flow positive in 2023?

Doug Rice

That's a good question, Jim. Thank you.

On inventory, net inventories, up in the \$15 million range that you suggested, about half that is from raw materials as we tried to take any slack out of anticipated supply chain issues, and our procurement team has done a terrific job of making sure that we haven't missed any production, or have any issues from any of those parts. We're happy with where we are from an inventory perspective. Now, I wouldn't expect much more inventory build through the remainder of the year.

Yes, is the answer to your last question in terms of positive cash flow in '23 and beyond.

Jim Sidoti

All right, thank you.

Jon Serbousek

Jim, if I might add one other thing to your ASC discussion on components. We've watched Virtuos, which is a shelf-stable complete autograft substitute to work with MTF Biologics. It's a very appropriate product for the ASC, as well as with Legacy. And Legacy, which is that DBM product, is another appropriate ASC market. We're purposely building the portfolio to go across not only the ASC, but the hospital; but we're also on a global basis. We talked about our success with orthopedics and have 11% growth there. We built that, it's predominantly in a European channel, but we're basically increasing our U.S. channel area. Then many of those cases can be done in an ASC. or moving towards an ASC, in that regard, as well. We feel good about where we're at across not only spine, but also our orthopedics business, along with our biologics. I think we're well positioned for the future, where to do as we've talked about where to transition or transformation point in our strategy, and there's a number of factors that are coming together into a confluence right now, and that's what we're managing through and it's what we're articulating to you.

Jim Sidoti

Understood. Thank you.

Jon Serbousek

Thanks, Jim.

Operator

Thank you for your question, Jim.

There are no further questions at this time. I would like to hand back to the management team for any closing remarks.

Jon Serbousek

I would like to thank everyone for their attending the call, and their continued interest and support Orthofix going forward, and have a wonderful day. Thank you.

Operator

Thank you. This concludes the call today.