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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Merit Medical Systems, Incorporated Third Quarter 2018 Earnings Call. (Operator Instructions). As a reminder, today's conference is being recorded. I'd now like to introduce your host for today's conference, Mr. Fred Lampropoulos, Chairman & CEO. Sir, please go ahead.

Fred P. Lampropoulos *Merit Medical Systems, Inc. - Chairman, CEO & President*

Good afternoon, ladies and gentlemen, and thank you for joining with us. We are assembled at our corporate offices on a lovely fall day in Salt Lake City. We'd like to start the meeting out by having our General Counsel, Brian Lloyd, discuss our safe harbor provision. Brian?

Brian G. Lloyd *Merit Medical Systems, Inc. - Chief Legal Officer & Corporate Secretary*

Thanks, Fred. During our discussion today, reference may be made to projections, anticipated events or other information, which is not purely historical. Please be aware that statements made in this call, which are not purely historical, may be considered forward-looking statements.

We caution you that all forward-looking statements involve risks, unanticipated events and uncertainties that could cause our actual results to differ materially from those anticipated in such statements. Many of these risks are discussed in our annual report on Form 10-K and other reports and filings with the Securities and Exchange Commission available on our website. Some of these risks are identified in our press release and slide presentation distributed in connection with this call.

Any forward-looking statements made in this call are made only as of today's date and, except as required by law or regulation, we do not assume any obligation to update any such statements whether as a result of new information, future events or otherwise. Please refer to the section of our presentation entitled Disclosure Regarding Forward-looking Statements for important information regarding such statements.

Our financial statements are prepared in accordance with accounting principles, which are generally accepted in The United States. However, we believe certain non-GAAP financial measures provide investors with useful information regarding the underlying business trends and performance of our ongoing operations and can be useful for period-over-period comparisons of such operations. The tables included in our release and discussed on this call set forth supplemental financial data and corresponding reconciliations to GAAP financial statements.



Please refer to the sections of our presentation entitled Non-GAAP Financial Measures and Notes to Non-GAAP Financial Measures for important information regarding non-GAAP financial measures discussed on this call.

Readers should consider non-GAAP measures in addition to, not as a substitute for, financial reporting measures prepared in accordance with GAAP. These non-GAAP financial measures exclude some items that affect net income. Finally, these calculations may not be comparable with similarly titled measures of other companies.

Fred P. Lampropoulos *Merit Medical Systems, Inc. - Chairman, CEO & President*

Brian, thank you very much. And again, ladies and gentlemen, thank you for joining us.

I think you can see by reading our report that the third quarter was, in my opinion, a great quarter. As you all know, summer quarters are always a little testy. They're unpredictable. It has to do with a lot of factors: weather, buying patterns, a lot of things that go into it every year. And some of you remember last year we were a little slow on the revenue side. This year, at least from our internal projections, I think we did very, very well.

I think the interesting point to note, lest one think that it's one area or another, that this growth, which again also contributed to gross margins which I'll get to in a moment, was across the board. Some of our products like our Guide Wires are up 25%. Our Fountain catheters, these are thrombolytic catheters, are up 40%. Our DualCap, which is a business that we acquired of antiseptic caps well over a year ago, is up over 40%. And so these are coming from all geographies and all product groups. So it's an exciting time. Business continues to be robust and we're quite excited about it.

Just a couple of things that I think will be of interest and then I'll turn some time over to Raul Parra. But the core growth. You know, as many of you who have followed the company for many years know, I think the strength of Merit, as I point out in my comments, is really that we have this really robust research and development activity going on in a number of our facilities worldwide. Whether it be in France, whether it be in the Netherlands, whether it be in Ireland, in a number of locations in the U.S., in Singapore, there's just a lot of activity. And when these things come together, when we introduce new products, it, I think, really stands out as maybe one of the most differentiating features of the business.

In addition to that, as you know with our acquisitions and bolt-ons, those also come up to anniversary dates. And almost all of those and almost immediately after the close, Merit starts innovating and unlock this wonderful potential that these companies have where they have, for many reasons, have been either stymied or less active in their research and development. So these are things that we take pride in and I'm often asked, "Well, how do you guys do this?" And I've just given you the answer. It is that robust pipeline. It is what I call the Merit mosaic; that everything we do ties in with something else and, in fact, connects all the way around.

And then I think the continuous improvement part of our business, as you can see and you'll recall from the last quarter, we were up 140 basis points from the first quarter, and this quarter we were up another 90 basis points on a non-GAAP basis, I believe, Raul. I'm maybe stealing a little of your thunder. But it's that sequential improvement in gross margins that we talked about. And you'll also recall that we said that we would be back on the last half of the year at that 100 to 150 basis points. And Raul, again, you're almost here, Raul. Stay with me now. So I mean I think the business is doing well. I'll talk a little bit further about some more of the internal types of product issues that we think are driving the business.

But let me turn some time over to Raul Parra, our Chief Financial Officer. And just before I do that, Raul, I want to look you straight in the eye and tell you I think you're doing a terrific job. I think that you're helping our business and the team you've put together has been terrific. And I just want to express my appreciation to you personally and then I want our shareholders and investors to understand my pleasure with the work that you're doing and your team is doing. So with that said, you're speechless. I can see that.



Raul Parra Merit Medical Systems, Inc. - CFO

Yes, I am. Well, thank you, Fred. And I'd like to publicly thank my team. They're doing a great job and they've been amazing and they continue to deliver on a daily basis. So thank you to them.

And just to highlight, I guess, what the quarter looked like. Revenue, we'll start there, Q3 revenue was approximately \$222 million as reported, a 23.6% increase over the comparable period of 2017 and a 15.4% on an organic constant currency basis. Year-to-date 2018 revenue was approximately \$650 million as reported, a 21% increase and a 10.8% growth on an organic constant currency basis. The competitor opportunity that we had previously discussed added revenue of approximately \$4 million. Excluding that opportunity, our organic constant currency revenue was still strong for the quarter at 12% and in line with our expectations to reach our constant currency core growth of 10% to 11% on the previously provided guidance. And to back up what you said earlier, some of the highlights include overall strong growth both in the U.S. and O.U.S. with the U.S. direct team up 8%, worldwide dealers up 17%, EMEA up 22% and OEM up 31% on an organic constant currency basis. So really strong revenue growth.

Gross margin, margin for Q2, non-GAAP margin was 49.8% compared to 48.1% for the comparable period. That's a 170 basis point improvement, as you mentioned, for the comparable period and a 90 basis point improvement from Q2 2018. Year-to-date, our non-GAAP margin -- our non-GAAP gross margin was 48.7% compared to 48.2% for the comparable period. That's a 50 basis point improvement. We continue to leverage our margin with improved manufacturing efficiencies, obsolescence and product mix. We expect our margin to operate in the range previously given to reach our guidance of 80 to 130 basis points.

OpEx, they were in line with our expectations, 35% of revenue. Nothing significant there. EPS, earnings were \$0.47 for Q3 2018 compared to \$0.32 for the same period in 2017. The benefit from stock option tax was \$0.02 in Q3 of 2018. Again, our increased revenue, our margin expansion and operating expenses -- expense discipline continue to drive increased earning for us. So overall, really strong performance.

As we look forward, just as a reminder, the remainder of the year the business continues to be strong. I'd like to point out that we had factored that strength into our updated guidance during our Q2 call. Given our robust business and all the discussions of headwinds taking place in the markets right now around tariffs, elections, FX and labor, we feel pretty comfortable with the middle range of our updated guidance. Just as a reminder of what that midpoint looks like, it's approximately \$870 million to \$880 million in revenue, core growth on a constant currency basis of 10% to 11% for the year and EPS guidance of \$1.60 to \$1.70 for the year. That's it.

Fred P. Lampropoulos Merit Medical Systems, Inc. - Chairman, CEO & President

Well, I think, Raul, again by any measure, I comment on that, it was very pleasing. And just as a reminder to everybody, while all of this is going on and we're running the business, we were also working on and finalizing the largest transaction in Merit's history with Cianna. Now it's our expectation that sometime in November that will close. And when we know when that happens, in our next call we'll be able to kind of give you the forecast. We just don't know when it is, but we think it's very likely to be in November.

I think, as I mentioned, if you look at all the geographies, but particularly Europe. Europe really, really did a good job this last quarter and I think the way that that business is performing. Asia, Southeast Asia. Even the U.S. is picking up their step. So just as we look at the business, OEM is very, very strong. So just kind of across the board, our business is doing well.

I think, do you want to just briefly talk about the tax rate because I think that's just something -- because we had a relatively low tax rate this quarter and maybe a little color on it, Raul.

Raul Parra Merit Medical Systems, Inc. - CFO

Yes. So typically in Q3 we do have a lower tax rate just because some of the stuff that rolls off for FIN 48 liabilities. And then we also had the benefit on stock options, which we continue to benefit from. Again, that's a hard one for us to forecast. And as we look forward, I think for the fourth quarter we've tried to forecast -- essentially we forecasted a rate somewhere in between 25% to 28% for the fourth quarter. That's excluding any stock option exercise benefits that we anticipate getting. We just don't know what those are and so want to make sure that people have a range to work with.



Fred P. Lampropoulos Merit Medical Systems, Inc. - Chairman, CEO & President

And we'd be remiss if we didn't mention that during the quarter we also did an equity raise that was about \$217 million, give or take, that was headed by Wells Fargo and Piper and a number of people who have been involved in the company for a very long time. So Raymond James, Canaccord, a whole bunch of folks. I'm going to leave somebody out and somebody's going to be mad at me. But again, I think that's important to note as well.

All in all, the business is strong. We have a new facility under construction to give us additional capacity. That will come on in March. The R&D pipeline is full. I made comments in the press release about the EmboCube, which we're very excited about, as well as -- I'm trying to think what the other one is. I've got to look it up here. Oh, the mini-stent.

Raul Parra Merit Medical Systems, Inc. - CFO

Yes.

Fred P. Lampropoulos Merit Medical Systems, Inc. - Chairman, CEO & President

So that was another I think that in the latter half of the year, and I apologize for that hesitation, but in the latter half of the year, if you take a look at our endoscopy business, it has done very, very well. It was a little soft the first half, but I think with the NinePoint and with some of the new products and the focus, we've done very, very well there.

The new product pipeline is full. A bunch of products are rolling out. We expect to see some steam coming from those as we move forward; a new inflation device, a new vascular access device. We just introduced, not long ago, our new Pursue microcatheter and that is doing very well. So I mean I just think across the board we're playing ball. And I think we're doing a good job.

So to my staff -- and you know they're doing a great job, but I want to point out operations because we talked about the sales and all that kind of stuff, but someone's got to build this stuff and someone's got to ship it and build it well and do it properly and all of the various issues that are involved with a medical manufacturer. Our operations group is doing a superb job. So again, thanks to everybody on the staff side.

We hope that you're pleased with the earnings side of it. Look at the -- just hitting the numbers or exceeding those numbers. I can't say that we expected all of this. We always, as you know, guide down in the third quarter because of the summer. You never quite know. But look, every once in a while you -- something like this happens across the board in all product groups and all geographies. In the summer. I think that bodes well for the business going forward.

So with that being said, I think that generally covers our comments in the quarter. As a reminder, Raul and I will be here for a good hour or 2 following this for any clarifications on issues. And now we're pleased to take the time to answer your questions to the best of our ability. So we'll turn the time over to our administrator and we'll start taking your calls. And thank you very much for your attendance and we'll go ahead and take the calls now.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Our first question comes from the line of Larry Biegelsen with Wells Fargo.

Adam Carl Maeder Wells Fargo Securities, LLC, Research Division - Associate Analyst

It's Adam Maeder on for Larry. I guess I just wanted to start with one quick clarification on the 2018 guidance. The \$870 million to \$880 million range, that does not take into account any contribution from Cianna. Is that correct?

Raul Parra Merit Medical Systems, Inc. - CFO

That's correct.



Adam Carl Maeder Wells Fargo Securities, LLC, Research Division - Associate Analyst

Okay, perfect.

Raul Parra Merit Medical Systems, Inc. - CFO

And Adam we don't know the closing date and so as soon as we know that we can update that for this year. So that's the reason why.

Adam Carl Maeder Wells Fargo Securities, LLC, Research Division - Associate Analyst

Okay, understood. And then I wanted to ask about Terumo. So I heard you call it a \$4 million benefit in Q3. How are you thinking about Q4 and beyond? So I just wanted to ask about your latest thinking on the supply disruption. And any sense for when Terumo will be back at full strength or capacity? And then I have one follow-up.

Fred P. Lampropoulos Merit Medical Systems, Inc. - Chairman, CEO & President

Yes. It's a question of course I get asked all the time. And we try to be cautious. We know what the market opportunity is out there. We first heard June then July then August then September. The bottom line is, is our field intelligence -- now these are from sales reps and so it's hearsay and anecdotal in many ways -- but is that the problems continue. They are filling some, but I'm seeing reorders and new orders. So I have not seen it go away.

And I think I've said in some of the -- some people have asked me, "Well, how long do these go on?" They go on longer than you think. They're more difficult that you think. And the Merit will benefit substantially into the future. That's just the bottom line. Now, how much and this and that. But what it does is allow us to get into these accounts. People want to do business.

And the other really neat thing about this, Adam, is it's not just the wires or the microcatheters, but it's torque devices, it's this, it's that, it pulls a lot of other things along including our Guide Wires. These are, again, non-hydrophilic guide wires. So it just helps us in terms of being there.

And I think, going back to the summer comment about our European sales force, places still shut down, but our sales force didn't shut down. And I think that's the critical issue. They were out there. They took advantage of the opportunity and then we saw that in the quarter.

So the problem is still there. It continues on. They'll come back. It's a great company. But Merit is not going away.

Adam Carl Maeder Wells Fargo Securities, LLC, Research Division - Associate Analyst

Okay, Fred. Thanks for that. And then can I just maybe push? What is included in the guidance for Q4 for Terumo?

Fred P. Lampropoulos Merit Medical Systems, Inc. - Chairman, CEO & President

Well, I'm going to let you go ahead and comment on that, Raul.

Raul Parra Merit Medical Systems, Inc. - CFO

Yes. We included about \$5 million in our updated guidance.

Adam Carl Maeder Wells Fargo Securities, LLC, Research Division - Associate Analyst

Okay. And then sorry to squeeze maybe one more in. Just as we start to think about 2019, what are some of the puts and takes you would call out in regards to next year? And then I know the LRP calls for about 8% organic constant currency growth. But in theory you'll have 2 quarters of benefit from Terumo in terms of a year-over-year comp standpoint. So is 8% organic constant currency growth next year still a good starting point? Or should we be thinking about something potentially higher than that?

Fred P. Lampropoulos Merit Medical Systems, Inc. - Chairman, CEO & President

Yes. I think what we're going to -- I mean if you look -- listen, here you are with these numbers that came up this quarter. And I'm just looking here. The organic is what? 10.8?

Raul Parra *Merit Medical Systems, Inc. - CFO*

Yes.

Fred P. Lampropoulos *Merit Medical Systems, Inc. - Chairman, CEO & President*

So we're running a little bit hot, which is kind of a nice thing to do, and we feel very strongly about the organic business and the benefit. I think what we'll do is we'll look at this quarter. We'll come out and give the full quarter. We'll have Cianna in there. We'll include the Terumo. We'll have another quarter of intelligence. So I think rather than -- I mean other than the comment that he made, that Raul made, about the \$5 million, we're going to wait until February. And then we can lay the whole plan out with another quarter of intel. So I think that's the important thing to do and the conservative and proper thing to do as well, Adam.

Operator

Our next question comes from the line Bruce Nudell with SunTrust Robinson Humphrey.

Stanislav Nykola Fediuk *SunTrust Robinson Humphrey, Inc., Research Division - Associate*

This is Stan Fediuk on the line for Bruce Nudell. So just wondering, get some modeling questions out of the way, what are your current acquisition revenue expectations for 2018 for BD Bard and excluding BD Bard?

Raul Parra *Merit Medical Systems, Inc. - CFO*

\$40 million to \$42 million is our updated guidance that we gave. And then another \$20 million to \$22 million on the other.

Stanislav Nykola Fediuk *SunTrust Robinson Humphrey, Inc., Research Division - Associate*

Okay. And full-year FX impact?

Raul Parra *Merit Medical Systems, Inc. - CFO*

We had somewhere around the \$7 million to \$9 million range.

Stanislav Nykola Fediuk *SunTrust Robinson Humphrey, Inc., Research Division - Associate*

Okay. And can you just provide an update on the manufacturing transition of BD Bard products to your facilities? And I believe you previously commented that there were automation opportunities there.

Fred P. Lampropoulos *Merit Medical Systems, Inc. - Chairman, CEO & President*

Yes. I think, first of all, we are on schedule, actually ahead of schedule. We just received approval from BSI to the broadening of the scope of our facility. So we have all of the regulatory requirements to produce there. We actually will start -- I think in the next week or so, we'll start the first phase of production. So we're starting that up. And then I think we're going to go probably into, I'm going to say, early third quarter of next year. I'm sorry -- March. And so anyway, it's moving along as expected, better than expected.

And to the automation issue. And again, I want to be careful how I phrase this, but we have -- we purchased new CNC equipment. We've purchased new, updated, I think more efficient equipment. So I think one of the big opportunities -- and I don't want to call it a surprise -- but one of the things that I think we've done is we think that our output and our costs are going to be coming in a little bit better than maybe you expected because of the efficiency of the equipment that we've purchased and the training that we've done.

Operator

Our next question comes from Jason Mills with Canaccord Genuity.

Unidentified Analyst

It's Cecelia on for Jason. And I just wanted to ask, I guess Cianna was a fabulous acquisition, but as you're looking forward, what are you focused on, on the M&A front? What are you seeing on the market right now? And just your thoughts about balancing top-line growth and margin expansion when you're discussing acquisition prospects.

Fred P. Lampropoulos *Merit Medical Systems, Inc. - Chairman, CEO & President*

Listen, the business, the industry continues to consolidate. I think the key and the critical issue for Merit is always something that fits the Merit mosaic. It has to complement our business. It has to be scalable. It has to contribute. It has to do all the things, whether you look at the BD or the Cianna deal or any of our deals, it has to fit that model and the discipline that goes along with that model. So I think those are the things that we would look for.

As I mentioned in my meetings and on this call today, we're seeing 1 or 2 things almost every day. Most of them just get passed. But there are opportunities out there. We'll continue to look at those and look at the scalability of our overall business. And if it fits, it meets the profile financially and can be absorbed by our sales force, we're going to look at these things. So we continue to be a buyer for the right businesses that meet those profiles.

Unidentified Analyst

Okay, great. Thank you. And then just one question we hear a lot from investors is around free cash flow conversion. I was just wondering if you could comment on improvements or progress or a focus within your company right now on driving improvement.

Fred P. Lampropoulos *Merit Medical Systems, Inc. - Chairman, CEO & President*

Yes. Cecelia, it's a good question and one that we do get asked. But I would like to remind everybody that I think our overall growth this year is going to be better than 20%. That means our business under the Rule of 72 is going to double in 3.5 years if you were able to keep up with that growth rate. Now that does include, of course, some acquisitions.

We've started to run into a little issues in terms of capacity. We have plenty of capacity in Mexico, but we're running out a little bit of capacity here so we've started a new facility here near the Salt Lake or on the Salt Lake campus. It is a different type of construction. We're talking about \$9 million. And remember, we have the issues that have to go to finish up the automation, the things that go into Mexico plus additional automation of products that are growing dramatically.

So as we look at CapEx, we've talked about in the past few years we've been at 30 to 35. With the acquisition, we're going to be closer to 50 to 55 this year. I think as we're looking to next year, we're going to have a little bit higher because of the projects and other things that we're doing. So but we understand the issue, but we also are a growth company and we have to fund that growth and it takes capital to do so. Now that being said, Mr. Parra, your thoughts.

Raul Parra *Merit Medical Systems, Inc. - CFO*

Yes. I think you said it perfectly. I know we are working on our working capital too, trying to find efficiencies there. So overall, I think it's an increased focus for us. (inaudible) capital expenditures I think we're trying to be smarter on how we do our buildings. And other than that, I think Fred covered everything.

Operator

Our next question comes from Matthew O'Brien with Piper Jaffray.

Matthew Oliver O'Brien *Piper Jaffray Companies, Research Division - MD and Senior Research Analyst*

Three questions for me. Just, Fred, am I doing the math right? I think you had mentioned the Terumo opportunity as being something around \$0.5 billion on an annual basis, something along those lines. So that means in the quarter it was about \$125 million opportunity and you captured \$4 million, so about 3% share. Is that math about right? And then as we think forward, is this an area that capturing more and more percent share of that is possible even as they get back on the market? Should it accelerate? Or is this about the level we should expect going forward?

Fred P. Lampropoulos *Merit Medical Systems, Inc. - Chairman, CEO & President*

Let me talk, Bruce, from that top number. I think -- or Matt, excuse me -- from that top number. So the market that we see for their products is somewhere around \$750 million. We see -- of all the product lines. This is microcatheters, hydrophilic catheters, guide wires, and so on and so forth. They indicated in their press release that they thought that they would lose about \$100 million of revenues. In this particular case, we estimate it was \$4 million. We think it will be \$5 million. I think there was a number that came out somewhere in the

press that said there was a market opportunity for Merit from \$25 million to \$50 million over a 12-month period. I think those numbers are reasonable numbers in terms of what Merit will get out of this.

And I also believe that it's a longer-term opportunity. I think it allows Merit to show their wares. And they include things that Terumo doesn't have; things like the new Pursue microcatheter, the Ninja, some of our torque devices, guide wires. So it helps us to just have a broader view and I think, very candidly, a greater appreciation from our customers for the things that we can provide. In some cases, before, you just couldn't get an audience even though they were buying some of our other products, inflation devices and this and that. So I think it gives us more opportunity.

And it's just like the Cook deal. I'd like to go back to Cook. Cook is a great company. Terumo is a great company. They had a problem. There was an opportunity. I think we were conservative in our numbers as it started. Remember, the numbers we talked about were in the summer. That's still a very big deal. And so I would expect that in the fourth, fifth -- excuse me -- fourth quarter and the first quarter we'll continue to see this improve. I think I can say that with relative confidence at this point based on the intelligence in the ground that I have today.

Now everybody thought that whole thing would be over on the Cook catheters. Well this also plays into that product line because there are catheters and hydrophilic catheters, and if we look at, for instance, our Impress catheters for the year, we're talking about a 21% increase, and on the hydrophilic side, which includes some of the product, a 37% increase year-to-date. So this party is not over by a long haul. And they're looking for, very candidly, customers are looking for a backup source.

One other point on this. In the past, a lot of people have been drinking Kool-Aid in terms of single source. Well if we look at last summer and look at saline from a provider, if you go take a look at the Cook situation, you go take a look at the Terumo and there will be others, I think maybe one of the biggest benefits is the issue of single source from a hospital to drive compliance and pricing. Those days are over because it's just not smart. If I only had a single supplier for a product or for a component, I'd have my board and everybody else and my shareholders all over me. So I have backups. But the hospitals have done something different over the last 4 or 5 years and those days are done.

So I think they're wising up. They're seeing that they have to have alternatives. I think that's maybe the biggest long-term benefit from this is that Merit has a bigger audience and an audience that will listen and needs our products. So that's a long treatise almost on why I think this is a long-term opportunity, to answer your question.

Matthew Oliver O'Brien Piper Jaffray Companies, Research Division - MD and Senior Research Analyst

That was super helpful, Fred. So just to clear up the guidance a little bit too for Q4. At the midpoint of the range, and if you take out the extra \$1 million sequentially from Terumo, it's only about a \$4 million increase sequentially. Given all the strength that you're seeing, given what we saw this time last year, that would be a little bit of a slowdown sequentially. And I know last year was actually a pretty big Q4 from Q3. So is there anything in there specifically to point to that you're trying to account for? Or is there just a layer of conservatism in there?

Fred P. Lampropoulos Merit Medical Systems, Inc. - Chairman, CEO & President

Well I think there's FX that we have to think about. That's been something we're concerned about. I think we are, in fact, trying to be conservative. We don't want to make something we can't hit or something changes. We want to allow ourselves some room. So I think we're being conservative and I think you have to take into account the FX issues.

Matthew Oliver O'Brien Piper Jaffray Companies, Research Division - MD and Senior Research Analyst

Okay. And then finally, one for Raul. Your gross margin was obviously quite strong in the quarter, great to see on a year-over-year basis. Can you talk a little bit about some of the different factors that drove that higher? And then with the new facility, are we going to have any kind of headwind for a couple of quarters on the gross margin line that we should account for?



Raul Parra Merit Medical Systems, Inc. - CFO

No, we factored that into our updated guidance. Factors, I think it's the same story. We continue to drive manufacturing efficiencies. Our obsolescence was pretty good this quarter and as we continue to focus on making sure we keep that in line. And then really our sales departments driving that product mix that we needed. Overall, I think those 3 factors and the release of new products is really helping.

Operator

Our next question comes from Jayson Bedford with Raymond James.

Jayson Tyler Bedford Raymond James & Associates, Inc., Research Division - Senior Medical Supplies and Devices Analyst

Just a couple follow-ups there. Raul, maybe you can comment on what gross margin looks like or your expectation is for the fourth quarter just given the strength here in the third quarter.

Raul Parra Merit Medical Systems, Inc. - CFO

Well we don't give quarterly guidance, but I think we did hit on our updated guidance that we had given and we said we'd be in that range. So I think somewhere in the -- we gave you the range, I guess. It's somewhere in that ballpark.

Fred P. Lampropoulos Merit Medical Systems, Inc. - Chairman, CEO & President

Good boy, Raul. Well done. I think that helps you. I think you know you have this quarter. I think we have those efficiencies there. We did a nice job. But you'll recall that we said that in the last half of the year, we would operate on the basis of that 100 to 150 and we gave that updated guidance so I think we're in that.

Raul Parra Merit Medical Systems, Inc. - CFO

Yes. Maybe this will help you a little bit. I think the second half essentially what we said is that we would be operating in the 49.7 to 50.8 range. And then our updated guidance included gross margins of 48.9 to 49.4 for the year. So hopefully that helps narrow it down for you.

Jayson Tyler Bedford Raymond James & Associates, Inc., Research Division - Senior Medical Supplies and Devices Analyst

Okay. Okay, helpful. In terms of the Terumo benefit here, is the \$5 million in Terumo you mentioned in fourth quarter? Or is that \$5 million part of the annual guide of 870 to 880?

Fred P. Lampropoulos Merit Medical Systems, Inc. - Chairman, CEO & President

Go ahead.

Raul Parra Merit Medical Systems, Inc. - CFO

Yes. It was third and fourth.

Jayson Tyler Bedford Raymond James & Associates, Inc., Research Division - Senior Medical Supplies and Devices Analyst

Okay. So \$5 million for third and fourth. \$4 million of that was recognized in the third quarter.

Raul Parra Merit Medical Systems, Inc. - CFO

That's right. Again, we don't have visibility. I mean we see the orders and there's a lot of demand, but we wanted to make sure we were conservative.

Fred P. Lampropoulos Merit Medical Systems, Inc. - Chairman, CEO & President

And I think, Jayson, we're not seeing the orders fall off. So we're seeing reorders and then we're also seeing the new business. So that momentum is I feel comfortable with that. But there could be more than that. I don't see any less than that. But we'll see how it shakes.

Jayson Tyler Bedford Raymond James & Associates, Inc., Research Division - Senior Medical Supplies and Devices Analyst

Okay. Yes, I think there was just a little confusion around \$4 million in third quarter and then an incremental \$5 million in the fourth. Okay. So the implied organic growth in the fourth quarter is about 10%. Is that correct?



Raul Parra *Merit Medical Systems, Inc. - CFO*

Yes. Maybe a little bit higher.

Operator

Our next question comes from Jim Sidoti with Sidoti and Company.

James Philip Sidoti *Sidoti & Company, LLC - Research Analyst*

So in the quarter you said there were about \$16 million in sales of acquired products. Can you just remind me what's in there besides the Becton Dickinson products for this quarter?

Fred P. Lampropoulos *Merit Medical Systems, Inc. - Chairman, CEO & President*

Yes. We did a deal on some balloons. I think it was called First Call. Isn't that the name of the business?

Raul Parra *Merit Medical Systems, Inc. - CFO*

Direct Access.

Fred P. Lampropoulos *Merit Medical Systems, Inc. - Chairman, CEO & President*

Direct Access. So there's some balloons in for that. What else?

Raul Parra *Merit Medical Systems, Inc. - CFO*

ITL.

Fred P. Lampropoulos *Merit Medical Systems, Inc. - Chairman, CEO & President*

ITL, which was down in Australia.

Raul Parra *Merit Medical Systems, Inc. - CFO*

A little bit of Laurane. NinePoint. Really NinePoint and BD are the 2 big ones.

James Philip Sidoti *Sidoti & Company, LLC - Research Analyst*

Okay. Because when you did the BD deal, you said, I think it was about \$46 million on an annual basis. It seemed like you're running ahead of that. Is that correct?

Raul Parra *Merit Medical Systems, Inc. - CFO*

So our original guidance included \$37 million to \$44 million in BD for 2018. And then our updated guidance included \$40 million to \$43 million.

James Philip Sidoti *Sidoti & Company, LLC - Research Analyst*

Right. But that was for just for this year. On an annual basis, I thought you were around \$46 million.

Fred P. Lampropoulos *Merit Medical Systems, Inc. - Chairman, CEO & President*

That was the top side of our -- it's on the top side of the range?

Raul Parra *Merit Medical Systems, Inc. - CFO*

Yes. If you take 12 times units. That's a fair number.

Fred P. Lampropoulos *Merit Medical Systems, Inc. - Chairman, CEO & President*

I think the thing that's important here is it's exceeding our expectations and we're beating the numbers there. Yes. Is that helpful, Jim?

James Philip Sidoti *Sidoti & Company, LLC - Research Analyst*

Yes. That's what I was trying to get out. On the organic growth, you had 28% growth with the CRM business, 44% growth with the endoscopy business. Is that all new products?



Fred P. Lampropoulos Merit Medical Systems, Inc. - Chairman, CEO & President

No. No, I mean there are things in the endoscopy side that are things like our balloons. Elation balloons continue to go very nicely. There was some business in there from NinePoint. So there's some of that. I think when you go take a look at some of the other areas -- what was the other one you mentioned, Jim? I'm sorry. That was the endoscopy.

James Philip Sidoti Sidoti & Company, LLC - Research Analyst

The Thomas business, the CRM business.

Fred P. Lampropoulos Merit Medical Systems, Inc. - Chairman, CEO & President

Oh, yes. Well listen, it's transseptal needles. It's many of the Worley system, which is the coronary sinus guides.

Raul Parra Merit Medical Systems, Inc. - CFO

The sheaths.

Fred P. Lampropoulos Merit Medical Systems, Inc. - Chairman, CEO & President

The sheaths. That's the Heartspan. So I mean and again that was in the summer. These have nothing to do with Terumo. These are just products that we have a long runway on. And then that would be the SNAP. This is our valve peelable sheath. So business is robust.

James Philip Sidoti Sidoti & Company, LLC - Research Analyst

All right. And then last 2 for me. Since you completed the stack offering about a third of the way through the quarter can you just give me what for a full quarter what the share count interest expense should be?

Raul Parra Merit Medical Systems, Inc. - CFO

Share count interest expense will be about \$1.5 million. Yes \$1.5 million is what we saved on the interest expense for the quarter.

James Philip Sidoti Sidoti & Company, LLC - Research Analyst

Okay. And how about the share count for the fourth quarter?

Raul Parra Merit Medical Systems, Inc. - CFO

So for the fourth quarter it will be fully in there so it will be 4 million shares.

Fred P. Lampropoulos Merit Medical Systems, Inc. - Chairman, CEO & President

Of additional. 4 million on top of the --

Raul Parra Merit Medical Systems, Inc. - CFO

Yes. We have about 2.7 million shares in Q3.

Fred P. Lampropoulos Merit Medical Systems, Inc. - Chairman, CEO & President

Jim, it's 2.7 million in the third and 4 million in the fourth.

Operator

(Operator Instructions). Our next question comes from the line of Mike Matson with Needham and Company.

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

Guess I just wanted to start with a couple of things, kind of macro things. So first currency. Currencies have kind of been moving. The dollar has strengthened some. So is that something you expect to be a headwind in the remainder of the year or into 2019 either from a top or a bottom-line perspective?

Raul Parra Merit Medical Systems, Inc. - CFO

Yes. And that's why we mentioned that we felt comfortable with the updated guidance kind of being in the middle there just because we are expecting those headwinds. We saw about a \$1.4 million impact on our reported revenues for Q3. And as you look at the rates right



now, they're -- well the dollar is getting stronger. So it's going to impact us in the Q4. But again, we anticipated that when we updated our guidance. And so I think we're -- we feel pretty comfortable with the guidance we gave.

Fred P. Lampropoulos Merit Medical Systems, Inc. - Chairman, CEO & President

Yes, Mike, just on another note, one of the advantages of a stronger dollar is as we take a look at the euro, we're seeing a weaker euro, and we have manufacturing, a substantial amount of manufacturing in Ireland.

Raul Parra Merit Medical Systems, Inc. - CFO

And operating expense.

Fred P. Lampropoulos Merit Medical Systems, Inc. - Chairman, CEO & President

And operating expenses. And those will be lower. So but we still have those headwinds, but we at least have it almost partially hedged on a natural hedge. So that's two sides, silver lining so to speak, yes.

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

And I guess the other thing is I think some of your debt is kind of variable floating rate. So the interest rates have gone up, been going up. So I mean is that something that could be a little bit of a headwind for 2019 as well?

Raul Parra Merit Medical Systems, Inc. - CFO

Well we have a hedge in place. And so we've got coverage there. Right now we're about 80% hedged because of the payment we did with the offering.

Fred P. Lampropoulos Merit Medical Systems, Inc. - Chairman, CEO & President

What's our effective interest rate right now?

Raul Parra Merit Medical Systems, Inc. - CFO

3.15 or...

Fred P. Lampropoulos Merit Medical Systems, Inc. - Chairman, CEO & President

3.15.

Raul Parra Merit Medical Systems, Inc. - CFO

3.25.

Fred P. Lampropoulos Merit Medical Systems, Inc. - Chairman, CEO & President

3.25. So I mean it's still well within I mean I think a very good rate. We're actually I think maybe even at Treasury level on that.

Raul Parra Merit Medical Systems, Inc. - CFO

That's about right.

Fred P. Lampropoulos Merit Medical Systems, Inc. - Chairman, CEO & President

It's not a bad borrowing rate.

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

And then just a question on Cianna deal also. What is the real call point? I mean who are the physicians that are using those products? And then which of your sales forces would be selling those products once you close the deal?

Fred P. Lampropoulos Merit Medical Systems, Inc. - Chairman, CEO & President

Yes. So one of the things that we did, Mike, is that we kept essentially their entire sales force. They are selling to surgeons. And there are specialty breast surgeons that do just those types of procedures. And radiologists. But those radiologists and these breast surgeons are also using biopsy devices. So they use many of our products and they'll use more of our products in the future. But that's the sales force.

And then we will go ahead and enhance that with additional hires that we'll put in that are all in our model. So I think some of the things we've learned just from history is we didn't want to destroy what we think is a very, very important team with a lot of momentum. So we've kept it in place. Now it will have a different senior management.

But I think one of the other things that has been very, I think, pleasing to me is the number of letters. I've probably received 15 or 20 letters from the sales force saying how excited they are to be part of the Merit team. They're looking forward to this and that. And so I haven't had that in the past. You get 1 or 2 here and there. But I've essentially had almost everybody on that sales team send me a note and share with me their excitement and they're looking forward to being part of Merit. So we're excited about that opportunity.

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

Okay, thanks. And then just one final question. Just wondering if some of the growth acceleration that we're seeing here -- I mean you were mentioning, one of the prior questions, these transeptal needles and things like that, which kind of made me think about some of these structural heart procedures, TAVR and Watchman and things like that. I mean is that -- and then complex PCI as well, radial, these kind of secular growth trends within the cardiology space. I mean is that -- how much of your business do you think is exposed to those trends? And is that kind of helping kind of lift your growth?

Fred P. Lampropoulos *Merit Medical Systems, Inc. - Chairman, CEO & President*

Yes. Let me start with the radial side of it. Merit has been a big proponent and one of the leaders, very candidly, in the adoption of what I call the radial revolution. You'll recall 5 years ago, it was maybe 5%. It's in excess of 50% in the United States, and I feel that in the next 4 or 5 years we'll be operating at levels that you see in Europe and in Asia. These are 70% and in some places as high as 90%. It's bona fide cost savings.

And just anecdotally, I was talking to a friend of mine not long ago. He pointed to me a little nick in his -- it looked like a little needle prick. And he had had a radial procedure and he said to me, "You know, Fred, why don't you get in this business? I went and I had a stent put in and I had a Band-Aid put on this. And this is like a piece of cake." Now this is from somebody out there. And I said, "Well, you know, we're actually kind of one of the leaders in this area." So we've been very active in that area and that is one of the areas that you're seeing grow. And that is like the PreludeSYNC. This is one of our closure devices. We have new catheters coming out, the longer lengths for radial. We have new sheaths. So that's a big part of it.

Now let's go over to the CRM side. We have 2 pieces of that business and that is that we sell through our direct sales force, but we're also a major provider on an OEM basis. And you'll recall, Mike, from our conversations that Merit has about \$100 million OEM business. So we provide products to St. Jude. We provide products to Medtronic. We provide products to -- let's see, who else do we have? Biotronic. Boston.

So we have distributors that work for us on that side and then we also sell the products direct. And it's just -- so we're not doing structural heart, but we're providing products that physicians use to -- for their armament of the products and tools that are used in those procedures. And all those things are growing very nicely for Merit.

Operator

Our next question comes from Mike Petusky with Barrington Research.

Michael John Petusky *Barrington Research Associates, Inc., Research Division - MD & Senior Investment Analyst*

A couple questions. I guess, Raul, the -- it seems like a number of companies are sort of struggling to dial in to the effective tax rate. As you kind of look forward -- and actually if you could repeat what you said as far as expectation for Q4 -- but as you look forward beyond Q4, I mean do you expect that maybe the effective tax rate actually ends up being maybe a couple hundred basis points lower than maybe you had thought previously? Or are you able to dial that in? Or are you still kind of working through that?

Raul Parra *Merit Medical Systems, Inc. - CFO*

I think we're still kind of working through it. There's just a lot of guidance that continues to come out on the tax reform. And so it's -- I think that's why you're seeing a lot of people struggle with it because things are just changing on a daily basis. And obviously stock

options, I can't anticipate when we're going to be in a blackout or what's going to happen or if people are going to elect to exercise. And so I think you add those 2 variables and it is kind of a hard number to forecast. I know that we -- excluding some of these items, we're pretty close to the range that we had given, but maybe a little bit lower than expected.

Michael John Petusky Barrington Research Associates, Inc., Research Division - MD & Senior Investment Analyst

I'm sorry. What did you say for Q4 the expectation?

Raul Parra Merit Medical Systems, Inc. - CFO

25% to 28%.

Michael John Petusky Barrington Research Associates, Inc., Research Division - MD & Senior Investment Analyst

Okay. And then do you, by any chance, have CapEx, D&A and stock comp that you can share?

Raul Parra Merit Medical Systems, Inc. - CFO

Yes. Yes, let me get it for you here. So \$15 million is the depreciation and amortization. And stock comp was \$1.7 million.

Michael John Petusky Barrington Research Associates, Inc., Research Division - MD & Senior Investment Analyst

And the CapEx? You may have mentioned it earlier. I didn't catch it.

Raul Parra Merit Medical Systems, Inc. - CFO

CapEx was, let's see, \$15.5 million.

Michael John Petusky Barrington Research Associates, Inc., Research Division - MD & Senior Investment Analyst

All right. Okay and then I guess just last question. Fred, as you kind of look at the next couple of years in terms of internal R&D, I mean are there things that you guys are working on in terms of product launches or potential product launches over the next say 12 to 24 months that you feel, "Hey, this could be a real needle-mover. This could be a game-changer." Are there things like that in the pipeline? Or are they more of an incremental nature?

Fred P. Lampropoulos Merit Medical Systems, Inc. - Chairman, CEO & President

Well I think we have a number of products and a very active R&D pipeline, Mike. I think we have 64 R&D projects. And as you'll recall, our research and development goes on in Ireland and goes on in Texas and Pennsylvania and Salt Lake City. And in Texas, a number of locations. And that's full.

I think one that we've talked about at conferences and that we're very excited about is the Rhapsody. This is a new stent product, vascular stent. I think we're going to conduct our first-in-man in the next few weeks, within the month, in Europe. And then we'll go through the process in Europe of getting the CE Mark. And then of course, we are then also going to have to conduct a PMA in the United States.

So we're going to talk more formally about this as we have our conversations in February and start to talk about the contribution. We should have a better feel about when this will roll out in Europe. But it's probably -- and listen, we've worked on it for 5 years.

And part of this transition of going from accessories to primary in therapeutic products and disease states is they take more time and more money. That being said, there are also greater rewards. So Merit is still committed to that transition, but it's going to take place over many, many years. So there are several products that are part of even that product line that will go on for 20 years.

So there's a lot of stuff, but that's the one that's coming right away. First-in-man, it's essentially a safety study then CE Mark approval that we will file for and away we go. So that's the one that I'm most excited about.

But listen, all these things all add up. I think, Mike, we had someone say to me recently, "You know, I've never really understood your business. You have all of these pieces." And then, of course then a situation develops with Terumo and we say, "Well we have this, this, this, this and this." 5 or 6 or 7 or 10 products that address the shortage or complement users. And all of a sudden now people start to understand the business; that all these little things, these little pieces to this puzzle, the Merit mosaic starts to come into focus to say,

"Okay, now I understand who you compete with." But if I just talk to you about a microcatheter you might not get too excited. Out here, whether it be Pursue, Maestro or Swift Ninja, we're developing a leadership position in microcatheters that have very nice products.

So a lot of things coming. (inaudible). We built this business on that tradition of core growth, R&D and then the right types of additions and bolt-ons to our business.

Operator

And I'm not showing any further questions in queue at this time. I'd like to turn the call back to Mr. Lampropoulos for closing remarks.

Fred P. Lampropoulos *Merit Medical Systems, Inc. - Chairman, CEO & President*

Well thank you very much, ladies and gentlemen. It's a busy day. A lot of calls out there, a lot of activity. And we want to thank you for taking the time to call in and ask your questions. As I mentioned, Raul and I will be here for the next couple of hours. We'll do our best to clarify. We will not offer any new or inappropriate so don't ask us those kinds of questions. But things that are appropriate we'll be happy to answer.

Listen, we have a great business. We have a global business. We have a business that has products in geographic regions; in Europe, in the United States, Central, South America. We have the right products. We have new products coming. We have infrastructure. We've got distribution. We've got the things that we need to build this business. I think we're doing what we said we would do; grow that top line, grow those margins.

No one mentioned on this call the discipline of the expenses. I'm proud of that. I'm proud of the team that we've put together that helps us and how our guys have really had that discipline to stay in line. And what that means is we're going to see better margins, better profits. And we've spelled that out in a plan for the last 4 years and we've hit those numbers.

And so I think we're very excited about the opportunities. We're excited about getting Becton Dickinson moved and the opportunities. One other thing we have is we have, going back to one of the previous questions, we have 4 new, improved, best-in-class biopsy devices. So as I mentioned, we don't just buy something and say, "Isn't this wonderful?" We buy it and we improve it. And we have some really exciting things in the biopsy market that I think are going to enhance our market share. And it's a big market out there. So we're just getting started on these things.

So the business is in good shape. And one other thing on the capacity. We have one building, but as Raul mentioned, we're using new tilt-up. It's about half the cost. Like our corporate headquarters facility that you guys have seen. So I think we're trying to be more thoughtful and more prudent on our CapEx. But at the same time, we are not going to fall into this trap of, "You can't do this and you shouldn't do that and you can't build the business and your CapEx." Because we have to invest. We have to allocate our capital to the things that will grow the business and help to improve profits and margins over the future. And we're committed to doing that.

So thank you again. We'll look forward to giving you our year-end results and then in February to spell out a plan, which I think you'll find intriguing. And we'll look forward to do that at the appropriate time. We'll go ahead and sign off, wishing you all the very best from Salt Lake City. Wishing you a good evening and all best wishes to the Boston Red Sox to sweep it in 4 games. Good evening.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes the program and you may now disconnect. Everyone, have a great day.

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