Merit Medical Systems, Inc(Q4 2023 Earnings)
February 28, 2024

Corporate Speakers

- Fred Lampropoulos; Merit Medical Systems, Inc.; Founder, Chairman and Chief Executive Officer
- Brian Lloyd; Merit Medical Systems, Inc.; Chief Legal Officer and Corporate Secretary
- Raul Parra; Merit Medical Systems, Inc.; Chief Financial Officer and Treasurer

Participants

- Jason Bednar; Piper Sandler; Analyst
- Steven Lichtman; Oppenheimer; Analyst
- Jayson Bedford; Raymond James; Analyst
- John Young; Canaccord Genuity; Analyst
- Michael Petusky; Barrington Research; Analyst
- James Sidoti; Sidoti Inc.; Analyst
- Michael Matson; Needham & Company; Analyst

PRESENTATION

Operator^ Welcome to the fourth quarter of Fiscal Year 2023 Earnings Conference Call for Merit Medical Systems, Inc.

Please note that this conference call is being recorded.

That the recording will be available on the company's website for replay shortly.

I would now like to turn the call over to Mr. Fred Lampropoulos, Merit Medical Systems' Founder, Chairman and Chief Executive Officer.

Please go ahead, sir.

Fred Lampropoulos^ Thank you very much. Welcome, everyone, to Merit Medical's fourth quarter of fiscal year 2023 earnings conference call.

I'm joined on the call today by Raul Parra, our Chief Financial Officer and Treasurer; and Brian Lloyd, our Chief Legal Officer and Corporate Secretary.

Brian, would you mind taking us through the safe harbor statements, please?

Brian Lloyd^ Thank you, Fred.

I would like to remind everyone that this presentation contains forward-looking statements that receive safe harbor protection in our federal securities laws.

Although we believe these forward-looking statements are based upon reasonable assumptions, they are subject to unknown risks and uncertainties.

The realization of any of these risks or uncertainties as well as extraordinary events or transactions impacting our company could cause actual results to differ materially from those currently anticipated.

In addition, any forward-looking statements represent our views only as of today February 28, 2024, and should not be relied upon as representing our views as of any other date.

We specifically disclaim any obligation to update such statements, except as required by applicable law.

Please refer to the section entitled Cautionary Statement regarding Forward-Looking Statements in today's press release and presentation for important information regarding such statements.

Please also refer to our most recent filings with the SEC for a discussion of factors that could cause actual results to differ from these forward-looking 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.

This presentation also contains certain non-GAAP financial measures. A reconciliation of non-GAAP financial measures to the most directly comparable U.S. GAAP measures is included in today's press release and presentation furnished to the SEC under Form 8-K.

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

Readers should consider non-GAAP financial measures in addition to, not as a substitute for, financial reporting measures prepared in accordance with GAAP.

Please note that these calculations may not be comparable with similarly titled measures of other companies.

Both today's press release and our presentation are available on the Investors page of our website.

I will now turn the call back to Fred.

Fred Lampropoulos^ Thank you, Brian. Let me start with a brief agenda of what we will cover during our prepared remarks. I will start with an overview of our revenue results for the fourth quarter. I will then discuss our continued growth initiatives program and related financial targets for the three-year period ending December 31, 2026, which we announced in a separate press release this afternoon. After my opening remarks, Raul will provide you with a more in-depth review of our quarterly financial results and the formal financial guidance for 2024 as well as a summary of our balance sheet and financial condition as of December 31, 2023.

Then we will open the call for your questions. Beginning with a review of our fourth quarter revenue performance, we reported total revenue of $324.5 million in the fourth quarter, up 10.6% year-over-year on a GAAP basis and up 10.3% year-over-year on a constant currency basis. The constant currency revenue growth we delivered in the fourth quarter was stronger than the high end of our range of growth expectations that we outlined on our quarter three earnings call. Specifically, we expressed constant currency revenue growth in the fourth quarter in the range of 5% to 8% year-over-year.

Importantly, the better-than-expected constant currency revenue growth in the fourth quarter was driven by a strong organic growth, reflecting particular strength versus expectations in our PI, CPS and OEM product categories and relatively balanced contributions to the upside in quarter four from both the U.S. and international markets. With respect to our profitability performance in the fourth quarter, we leveraged the strong revenue results delivered non-GAAP gross profit and operating profit growth of 13% and 13%, respectively, which resulted in year-over-year margin expansion of 100 basis points and 40 basis points, respectively.

We delivered non-GAAP net income and earnings per share results that modestly exceeded the high end of our expectations as well.

Overall, we believe our performance in the fourth quarter resulted in strong financial results versus our expectations and more importantly, capped off an impressive year of operating and financial performance in 2023, highlighted by nearly 10% constant currency revenue growth, improvements in our profitability profile with an 18.2% non-GAAP operating margin, a 120-basis point improvement year-over-year and strong free cash flow generation of more than $110 million. This performance continues to be a direct result of our team's continued hard work and commitment to our strategic objectives, and we're very proud of the strong execution our team delivered in 2023.

Our performance in the fourth quarter of 2023 also marked the completion of the third and final year of our Foundations for Growth program.

We are very proud of the team's strong execution and relentless focus on the multiyear strategic endeavor. It is because of their efforts that the FFG program has resulted in a constant currency organic revenue CAGR of 9.4%, a 440-basis point improvement in our non-GAAP operating margin and cumulative free cash flow generation of approximately $300 million. Notably, when compared to 2019, we delivered a constant currency revenue CAGR in excess of 6%, more than

630 basis points of non-GAAP operating margin expansion and cumulative free cash flow in generation of more than $418 million.

As announced in a separate press release this afternoon, we have formally introduced the continued growth initiatives program and related financial targets for the three-year period ending December 31, 2026. Building upon the notable success achieved in our Foundations for Growth program, the continued growth initiative program reflects our commitment to identifying opportunities to better position the company for long-term sustainable growth and enhanced profitability.

As discussed on prior calls, we wanted to use the Foundations for Growth program as a vehicle to think holistically and comprehensively across the business, to challenge the status quo and to deliver an ambitious improvement in profitability while preserving our historically market-leading growth profile, our legacy of customer-driven innovation and the strength of the Merit culture that has served us so well for so many years.

We believe we executed well over the last three years, and we're all very proud of the progress we have made with FFG. Importantly, we're not done. The CGI program represents the next chapter in our company development and a continuation of the momentum and commitment to improvement that has defined the company in recent years. To that end, the CGI program was established with three clear objectives in mind.

First, maintain above-market profitable growth, leveraging our proven ability to innovate together with our customers and deliver unique therapeutic based solutions to the market. Product offering optimization, including further SKU rationalization and advancement of pricing initiatives and prioritizing efficient customer-centric sales and service strategies, including engaging with customers through education. Second, significantly improve our non-GAAP operating margins through ongoing network consolidation, growing sophistication and forecasting, planning and tracking and continued focus on lowering costs and increasing efficiency throughout the organization.

Third, to strengthen the Merit Way culture throughout the organization, included targeted programs for enhanced employee engagement, leadership development and organizational development.

We are prioritizing further investment in our people with clear individual and functional objectives aligned with the company's strategic plan and key business objectives.

We believe strong execution towards this goal is integral to best position the company for sustained success in meeting the evolving needs of changing healthcare markets in the years to come.

As we formally kick off our continued growth initiatives program, it is important to understand that we have an organization that is fully committed to both the continued execution of foundation for growth activities and the successful execution of the new CGI objectives going forward. Together, we believe our efforts will result in merit completing the year ending

December 31, 2025, with more than $1.46 billion of revenue and non-GAAP operating margins of at least 20%.

We also believe our efforts will drive cumulative free cash flow generation of at least $400 million during the 3-year period ending December 31, 2026, which will significantly enhance our balance sheet and financial condition. With that, let me turn the call over to Raul, who will take you through a detailed review of our fourth quarter financial results and our 2024 financial guidance, which we introduced in today's press release as well as a summary of some of the key drivers of growth, profitability improvement and cash flow generation, we project as part of our CGI program.

Raul?

Raul Parra^ Thank you, Fred. I'll start with a detailed review of our revenue results in the fourth quarter, beginning with the sales performance in each of our primary reportable product categories. Note unless otherwise stated, all growth rates are approximated and presented on both a year-over-year and constant currency basis.

We have included reconciliations from our GAAP reported results to the related non-GAAP item in our earnings release and presentation available on our website. Fourth quarter total revenue growth was driven by 10% growth in our Cardiovascular segment and 20% growth in our Endoscopy segment.

Our cardiovascular segment was the primary driver of the better-than-expected revenue results versus the high end of constant currency growth expectations.

While our Endoscopy segment sales were in line with expectations. Sales of our peripheral intervention or PI products increased 19%, representing the largest driver of total cardiovascular segment growth again this quarter. Excluding sales of acquired products, PI sales increased 14% on an organic constant currency basis.

Organic growth in the PI product category was driven by sales of our drainage and radar localization products, which increased 19% and 18%, respectively, and together represented a little more than 40% of total PI sales growth.

And by sales of our access and geography and biopsy products, which together increased 13% and represented nearly a third of our total PI growth in Q4. Sales of both our cardiac intervention and OEM products increased 6% and were also key contributors to our organic growth in the Cardiovascular segment this quarter. Cardiac intervention product sales were at the high end of our growth expectations, driven primarily by strong sales of both our hemostasis and EP and CRM products, which increased 35% and 12%, respectively. Sales of our OEM products exceeded the high end of our growth expectations, which we attribute principally to continued solid demand from large customers in multiple categories with the strongest sales contributions from access and in geography products, which together increased 29% in Q4. Sales of our Custom Procedural Solutions, or CPS products, increased 1%, which was notably better than the mid-single-digit decline we expected in Q4.

CPS sales results benefited from higher demand from customers for certain product lines that have been identified for SKU rationalization as part of our foundations for growth initiatives. Lastly, sales in our Endoscopy segment increased 20%, which was in line with the range of growth expectations we outlined on our third quarter call.

As expected, we continue to see improving sales trends in the fourth quarter, and we're pleased to see this business deliver mid-teens growth in the second half of 2023. Turning to a brief summary of our sales performance on a geographic basis.

Our fourth quarter sales in the U.S. increased 13% on a constant currency basis and 9% on an organic constant currency basis, exceeding the high end of our growth expectations by nearly 300 basis points in the period.

Our U.S. growth performance reflects continued strong execution and overall improving trends in the U.S. market during the fourth quarter, particularly in our direct business, which saw impressive growth in sales of both our PreludeSYNC radial compression hemostasis device and our Splash Hydrophilic Steerable Guide Wire and geography products. International sales increased 7% on an organic constant currency basis, exceeding the high end of our growth expectations by more than 300 basis points in the quarter.

The stronger-than-expected organic constant currency growth to customers outside the U.S. was driven primarily by 7% growth in the EMEA region and to a lesser extent by 30% growth in the Rest of the World region and by 4% growth in APAC, which was in line with our expectations compared to growth that exceeded the hand of our expectations in the EMEA and Rest of World regions in Q4. With respect to China specifically, sales were essentially flat year-over-year and were impacted by the headwinds related to volume-based purchasing tenders as expected. Turning to a review of our financial performance across the rest of the P&L. For the avoidance of doubt, unless otherwise noted, my commentary will focus on the company's non-GAAP results during the fourth quarter of fiscal year 2023.

We have included reconciliations from our reported results to the related non-GAAP items in our press release and presentation at level on our website. Gross profit increased approximately 13% year-over-year in the fourth quarter.

Our gross margin was 50.4%, up 96 basis points from the fourth quarter of 2022. The increase in gross margin year-over-year was at the lower end of expectations as benefits from mix were partially offset by manufacturing variances compared to the prior year period.

Operating expenses increased 13% from the fourth quarter of 2022.

The year-over-year increase in operating expenses was driven by an 11% increase in SG&A expense and a 19% increase in R&D expense compared to the prior year period.

Our operating expense performance in Q4 of 2023 reflected higher commissions on the better-than-expected sales results and prioritization of investments to support our future growth initiatives as expected. Total operating income in the fourth quarter increased $6.7 million or 13% from the fourth quarter of 2022 to $59 million.

Our operating margin was 18.2% compared to 17.8% in the prior year period. The 40-basis point increase in operating margin was driven by a 96-basis point increase in our non-GAAP gross margin, offset partially by a 60 basis point increase in our non-GAAP OpEx compared to the prior year period.

Fourth quarter other expense net was $2 million compared to $0.1 million in the fourth quarter of last year. The change in other expense net was driven by an increase in net interest expense associated with increased borrowings and rising interest rates as well as lower income associated with realized and unrealized foreign currency losses compared to the prior year period, partially offset by an increase in interest income associated with our higher cash balances. Fourth quarter net income was $47.2 million or $0.81 per share compared to $46 million or $0.79 per share in the prior year period.

We are pleased with our profitability performance in the fourth quarter where we leveraged our stronger-than-expected revenue results to drive expansion in our gross and operating margins and non-GAAP diluted earnings per share that exceeded the high end of our expectations. Turning to a review of our balance sheet and financial condition.

As of December 31, 2023, we had cash and cash equivalents of $587 million, total debt obligations of $846.6 million and available borrowing capacity of approximately $626 million compared to cash and cash equivalents of $58.4 million, total debt obligations of $198.2 million and available borrowing capacity of approximately $523 million as of December 31, 2022.

Our net leverage ratio as of December 31 was 2.5x on an adjusted basis. The change in total debt obligation was driven by the issuance of convertible notes in December 2023. The notes bear interest at 3% per year, payable semiannually, mature February 1, 2029, and have an initial conversion price of approximately $86.83 per share. Total gross proceeds from the sale of the notes were $747.5 million and net proceeds were approximately $659 million after deducting offering and issuance costs and the cost of a related [Capco] transaction, which has an effective conversion price of $114 per share.

Initial use of proceeds was pay down of outstanding debt obligations at higher interest rates, specifically $138 million of revolver borrowings and $50 million of term debt.

We generated $55.1 million of free cash flow in the fourth quarter, up 255% from the fourth quarter of 2022 and up 30% from the third quarter of 2023. The improvement in free cash flow generation in the fourth quarter was primarily a result of significant improvements in cash used in working capital, specifically in the areas of inventory and accounts payable.

We generated more than $110 million of free cash flow in 2023. And as Fred mentioned earlier, are extremely proud of the significant free cash flow generation we have delivered as part of our FFG program, totaling nearly $300 million in the three years ended December 31, 2023.

Importantly, not only do we expect strong free cash flow generation to continue, we expect enhanced free cash flow generation over the next three years. Specifically, we believe our CGI program will generate more than $400 million of free cash flow in the 3-year period ending December 31, 2026. Turning to a review of our fiscal year 2024 financial guidance, which we introduced in today's press release. For reference, we have included a table in our earnings press release, which details each of our formal financial guidance items and how those ranges compared to the prior year period.

We expect GAAP revenue growth of 4.3% to 5.4% year-over-year. The GAAP net revenue guidance range assumes net revenue growth of approximately 4% to 5% in our Cardiovascular segment and net revenue growth of approximately 8% to 9% in our Endoscopy segment and a headwind from change in foreign currency exchange rates of approximately $5.9 million or approximately 50 basis points to growth year-over-year. Excluding the impact of changes in foreign currency exchange rates, we expect total net revenue growth on a constant currency basis in the range of 4.8% to 5.9% in 2024. There are two items to consider when evaluating our constant currency revenue growth of 4.8% to 5.9% for 2024. First, our ongoing FFG and CGI initiatives related to SKU rationalization represent a roughly $50 million headwind to revenue in EMEA and to a lesser extent, in the U.S. in 2024, representing roughly 120 basis point impact on our constant currency growth year-over-year.

Second, the midpoint of our total constant currency growth range assumes 7.6% growth in the U.S. and 2.3% growth outside the U.S. Constant currency growth outside the U.S. is expected to be driven by high single-digit growth in both the EMEA and Rest of World regions, partially offset by a 4% decline in the APAC region. The expected year-over-year decline in APAC sales is substantially related to China, where we expect to grow sales of units on a year-over-year basis, but we expect total revenue to decline due to continued headwinds related to volume-based purchasing.

Finally, our total net revenue guidance for fiscal year 2024 also assumes inorganic revenue contributions from the acquisition announced on June 8, 2023, in the range of $10 million to $11 million in the aggregate. Excluding this inorganic revenue, our guidance reflects total net revenue growth on a constant currency organic basis in the range of approximately 4% to 5% year-over-year. With respect to profitability guidance for 2024, we expect non-GAAP diluted earnings per share in the range of $3.28 to $3.35, representing an increase of 9% to 11% year-over-year. For modeling purposes, our fiscal year 2024 financial guidance assumes non-GAAP operating margins in the range of approximately 18.65% to 18.9%, up 50 to 75 basis points year-over-year. Non-GAAP interest and other expenses net of approximately $1 million compared to $10.7 million last year, non-GAAP tax rate of approximately 21% and diluted shares outstanding of approximately $58.8 million.

Finally, we expect CapEx in the range of $50 million to $60 million and free cash flow of at least $115 million. Lastly, we would like to provide additional transparency related to our growth and profitability expectations for the first quarter of 2024. Specifically, we expect our total revenue to increase in the range of approximately 5.6% to 6.8% year-over-year on a GAAP basis and up approximately 6.5% to 7%, 7.7% year-over-year on a constant currency basis. The midpoint of our first quarter constant currency sales growth expectations assumes approximately 10% growth year-over-year in the U.S. and approximately 3% growth year-over-year in international markets.

Note the midpoint of our first quarter constant currency sales growth expectations also includes approximately $6 million of inorganic revenue. Excluding these inorganic contributions, our first quarter revenue is expected to increase approximately 5% year-over-year. With respect to our profitability expectations for the first quarter of 2024, we expect non-GAAP operating margins in the range of approximately 16.7% to 17%, up 60 to 90 basis points year-over-year. Finally, we expect non-GAAP EPS in the range of $0.70 to $0.72. That wraps up our prepared remarks.

Operator, we would now like to open up for the line for questions.

QUESTIONS AND ANSWERS

Operator^ Thank you, sir. (Operator Instructions) Our first question comes from Jason Bednar with Piper Sandler.

Jason Bednar^ Congrats on a nice finish to the year, and I appreciate all the 2024 and CGI guidance color here. I'll pick up first on CGI. I don't think any of these ranges will really surprise investors that are close to your story, and that's not a criticism, more of a complement to the predictability here. The revenue guide here makes sense. I wanted to check to see if there's anything notable to call out as a tailwind or headwind embedded in that 5% to 7% growth outlook on, again in the CGI new products, regulatory elements, pricing, just anything there to be aware of?

Then on the margin side of the equation, I think the math works out to be something like 60 to 120 basis points of annual margin expansion at the operating line. Given what we're looking at for 2024, it looks maybe at the lower end of that, are there benefits here that skew more towards '25 and '26, I'm sorry to pack a few in here, but how do we think about the balance between gross margin expansion and OpEx leverage?

Raul Parra^ Yes. A lot to unpack there, Jason. So, I'm going to try and hit maybe on the revenue side.

So, if we think on the key drivers, at least on the 5%, right, we always like to start on the low end and then tell you what the upside would be depending on what happens. But look, I think it's really more of the same when it comes to the 5%.

Product introduction, selling the products that we have, we're really hitting on positive CAGRs in each of our reportable product categories, specifically PI and CI, CPS, OEM and Endotek with really the largest contributors coming from PI and CI. Then international CAGR is a little bit less than the U.S. CAGR.

So, it's really just a follow-on of really what we did with FFG, quite frankly.

So, that's on the revenue side. As far as on the operating margin piece, we really focused on the operating margin.

I would say that on the low end, the primary driver is going to be gross margin. When you get to the higher end, you're really leveraging up. You're getting more leverage from OpEx than what we would in the low end.

So, hopefully, that provides you a little bit of color.

Fred Lampropoulos^ And also, let me add this to that the revenue thing does not include new products. These are existing products. It does include wraps that we're currently selling, but no prognostications or any of the new products that Merit may release next year.

We have a long history of new product releases, but this is our existing business. And as they release and when they release, then we'll make notice of that.

Raul Parra^ Yes. That's a good point.

So, the Rhapsody, just for a point of clarity, it's really the outside of U.S. sales that we included in CGI, WRAPSODY U.S. sales, where we haven't been approved it have not been included as one would expect given that we don't know the exact timing, but we think we know when it's going to happen, but we weren't 100% sure. So, we didn't include it.

Jason Bednar^ Okay. Very helpful. Yes. You picked up on what I was hinting that there with WRAPSODY. So, that sounds like that's entirely upside and I appreciate all the details there on CGI.

On the guide for here for 2024, a few different moving parts here. I think core organic growth would be something like 5% to 6%, if not for that SKU rationalization you mentioned. Presumably, that SKU rationalization has some margin benefits. Can you talk about whether you're realizing these margin benefits here in 2024?

Are those and the EPS impact? Is that more of like a 2025 dynamic?

Raul Parra^ Yes. It's very similar to CGI.

So, on the low end, you're really talking about gross margin expansion. It's the main driver of that operating margin expansion as we make some investments in the business, especially as we ramp up for WRAPSODY.

Then and on the high end, you're getting more operating expense leverage that gets us to the higher end of that operating margin range.

So, hopefully, that helps, Jason.

Jason Bednar^ Yes. Sorry, I was asking gotten the SKU rationalization, in particular, that's going to be a, I guess helping or a benefit in 2024?

Raul Parra^ Yes. I mean it helps us out throughout CGI.

It's things we've been working out throughout the last several years, but it's included in the numbers.

Operator^ Our next question comes from Steve Lichtman with Oppenheimer.

Steven Lichtman^ And congratulations on the quarter. I guess a couple on cash. Is your higher free cash flow outlook as you look out over the next few years versus the last three based solely on higher operating income that you're forecasting?

Or are there working capital levers to that you see playing out?

And it looks like for '24, there's a step up in CapEx.

Anything to call out specifically on what that spend is directed toward.

Raul Parra^ Yes. So, on the CapEx, specifically around free cash flow.

So obviously, we're going to have higher earnings throughout the CGI program.

So, we expect that obviously to flow through. Now as far as the cash flow generation, I mean it will come from working capital.

We do expect CapEx to be somewhere in the 4% to 4.5% of sales. over the next several years.

We do have within the CGI three-year program, we will be making a couple of investments that I think we want to highlight just so we don't surprise anybody.

One is there will be a little bit of work that we'll do in our Mexican facility this year as we were able to obtain the other half of the building that we're currently in. So, now we have the two full buildings.

And we did that because it was advantageous. It was available, and we wanted the space. It's a lot easier to take it when it's available than when you need it.

Fred Lampropoulos^ Well, we don't want to have to be driving across town to do that.

Raul Parra^ So, it will be a nominal investment there as we build that out for whatever we need it. There's no immediate plans for it, but we have the space, and we'll do a little bit of work on it. The bigger one would be a distribution center that we're planning on doing here in Salt Lake. That will be about a $50 million spend. That is included in our free cash flow numbers, but I just want to call it out that it is something that we plan on doing.

We could get started as early as this year in the fourth quarter, but more than likely will get pushed into next year.

So, just a couple of callouts. But a lot of the drivers is increased profitability and working capital.

Steven Lichtman^ Great. Then just as a follow-up, given that free cash flow outlook and your solid balance sheet, can you provide just your latest thoughts on M&A, your appetite to do deals. Are you seeing opportunities out there? Any thoughts on that would be helpful.

Fred Lampropoulos^ Yes. Listen, I think we'll continue to identify opportunities.

We look at them all the time. They have to fit and not frustrate. I think if we go back and look at the last three years, in our opinion, the things that we did were things that we felt that would enhance the business, and that's the same ad. There's no money burning a hole in our pocket.

We will spend it when it's right. It's consistent with our sales objectives, our sales force, and it's consistent with our plan.

We see things, but that's it. I mean we're just going to keep the same discipline, the same approach that we've done in the past, but we have the cash to do it, and we won't be hesitant if we find the right things.

But it's just an ongoing process that is business -- I don't want to call it business as usual.

But for lack of a better word, that's exactly what we've been doing. And even at this point, it's been a couple of months.

We didn't have something that we're going to go do right away. We're looking and we'll be very patient and find the right things.

Raul Parra^ Yes. And also, just as a reminder, the CGI program does not contemplate any M&A activity.

Fred Lampropoulos^ That's a good point.

Operator^ Our next question comes from Jayson Bedford with Raymond James.

Jayson Bedford^ It looks like the cumulative free cash flow goal came in $600,000 shy of the goal. I'm not sure if you guys are fans of the movie Glengarry Glen Ross, but I really hope that Rule didn't get a set of stake no instead of the Cadillac Eldorado that he deserves.

Fred Lampropoulos^ No. They were actually plastic and wrapped in a wrapper.

Raul Parra^ Just a reminder, Jason, remember, we had that $12 million that had to be treated slightly different from a contingent payment standpoint because of the estimated fair value that we made four years ago or whenever it was. But yes, you're right.

We were just a hair short but honestly, I think after what we've been through, and all companies have been through from a supply chain standpoint from and everything that happened with Covid and whatnot. I think we're pretty proud of the team of what we were able to accomplish, to be honest.

To be within a rounding error of that, I think is a great example of the commitment that we've made as an executive team, and also our employees for towing the line on everything.

Jayson Bedford^ Yes. No doubt, you should be proud. So, that wasn't my question. It was just a comment. So, just two quick ones here.

It looks like the implied organic in cardio is about 4% I'm guessing it's disproportionately impacted by the SKU rationalization.

But ex the SKU dynamic, in which segment do you expect to see a bit of a slowdown. You called out TI and CI as the drivers. Where are you going to see the anticipated slowdown in '24?

Raul Parra^ Well, a lot of the rationalization comes from our kits and packs.

So, that's where we'll see most of the impact. But other than that, I mean, I think there is a little bit of MDR-related stuff, some of the spine business and whatnot.

But really, I think most of our growth is going to be coming from the U.S. at almost over 7%, 7.6% growth year-over-year and then about 2.3% growth outside of the U.S. So, hopefully, that helps.

Jayson Bedford^ Okay. Maybe just broadening it out a bit. Revenue growth, I think implied in the CGI, there's basically an acceleration in '25 and '26. Is the upper end all due to the potential success of WRAPSODY and just remind us on the anticipated timing there in the U.S.?

Fred Lampropoulos^ Yes, Jason, Fred. Look, it is weighted on the back end and almost all programs, you see that the three years. It's a little bit slower in the front. It depends on when we get approval on that thing, remember that revenue was not in the plan other than the existing.

But to say it's back weighted in '25 and '26 is fair.

Raul Parra^ Yes. And remember, as we talked about, we have some SKU rationalization that's happening this year, about $50 million. That's 120 basis points for this year.

So, as we get that behind us, then you start to accelerate back to what the to get us back into that 5% to 7% that you guys are used to.

So again, I think it's really just a timing thing from at least from a CAGR standpoint.

Fred Lampropoulos^ Yes. And another thing just to recall, we have existing products we're selling in the U.S. that because of the MDR and approaching the finish line for Merit, we will now start applying for those products. They're not in the numbers, but there are other things of these new products that we are selling in the U.S. that we haven't been selling so we could get MDR completed so I mean we feel comfortable with this.

I mean, I think you can tell that we feel comfortable with our sales guidance.

Raul Parra^ Yes. Again, I can't highlight enough the 120 basis points were -- that's a headwind related to SKU rationalization, which again I think everybody should be happy about that we're going through the process of doing that because at the end of the day it just leads to higher profits.

Operator^ Our next question comes from John Young with Canaccord Genuity.

John Young^ Congrats on a strong end of the year here. Maybe just to circle back to WRAPSODY, a follow-up on that question. I believe that you're supposed to complete the final patient follow-up in February, I think on 28.

So, just wondering if that was done.

Will the fan module still be submitted in Q2? And can you characterize the interactions with the FDA so far on it?

Fred Lampropoulos^ Yes. Listen, we have filed the first three modules.

The final one is the data, which is now being reviewed and populated and making sure that we have it all tidied up the way that the FDA requires it.

We're still on schedule to submit that per our previous calls, which is, I think in April or May.

But yes, we're on schedule for everything. Then at that point, John, it's in the hands of the FDA.

John Young^ Great. Then just when I think of the 2024 growth projection, how should we think about pricing power as a function of that growth?

Maybe any color on just contracts, do you expect to come out for renegotiation this year or just how the SKU rationalization get help push to higher priced products here.

Raul Parra^ Yes. Thanks, John. As you know, we don't disclose our pricing versus volume.

But just to give you guys some general context, I mean I think the pricing initiatives that we've set out we started under foundations for growth. They'll continue into CGI and they're just part of the initiatives that we're working on.

And so, we do expect it to be a tailwind for us, but we don't disclose the amount. It is one of the initiatives that we're working on among several others that we have going to get the CGI goals of at least or a minimum of 5% revenue CAGR and a minimum of 20% operating margins.

Fred Lampropoulos^ And John, maybe just a little bit of color on that is we have made it, I think very clear that going forward, the things that we learned from foundations for growth are not things that are forgotten. They are ongoing.

We have contracts that are coming due for renegotiation this, that and the other.

So, all of those things will come into play. And although we won't go through all the specific numbers.

The concept of attention to contracts pricing, engagement and all those things are still part of our program that we work on every single day.

We have our Chief Commercial Officer in the room, and I'm looking over at him and he's just nodding his head.

So that's his commitment. You can't see it, but I can and now we have this thumbs up.

So, there you go. Thanks, Joe.

Operator^ Our next question comes from Michael Petusky with Barrington Research.

Michael Petusky^ Congrats. So, a couple of my questions were asked and answered, but let me ask a couple more. In terms of the wage pressure that's going on in Mexico, I was just wondering if you could comment on that. I mean is that something that should be weighed or is that immaterial as you sort of think about the --

Raul Parra^ No. I think that's a great question, Mike.

I would say, generally speaking, that the wage pressures are, I would call them global, quite frankly. We've been pretty open about that throughout the last couple of years about some of the wage pressures that we're seeing globally.

The belief around at least this table is that we don't think those go away. I mean I think it's something that people are going to have to deal with.

We're dealing with the wage pressures in Mexico. It's something that we've been able to overcome. I think we have a good program in our Mexican facility on how we deal with our employees, and it's something that we've been working on to make sure that they are paid properly. We tend to be at the higher end of things.

So, I think the impact is less so than it would be for other companies.

But yes, it's something we're dealing with, along with the Mexican peso, like everybody else, but we are hedged, and it does spread over time, but I think we're well aware of it, and it's included in the numbers that we gave for CGI.

Fred Lampropoulos^ And I think that's the important part.

Some of this, by the way in Mexico was mandated. So, I mean everybody has to deal with it.

We have to follow along, and I think the next part of it, it's as Raul said, it's in the numbers. We've accounted in our costs, those particulars in our best guesstimate of what those numbers would be.

And so, we've built numbers and increases in things into our models.

Michael Petusky^ And I guess Fred, when you guys did the convert note a few months ago, I think probably a few people, I'll wrap myself out as one of those people probably suspect well, these guys probably have some things teed up in terms of external growth opportunities.

Obviously without getting us any specifics, I mean did you guys possibly have a couple of things that you thought were more front burner that now aren't maybe in that position.

Fred Lampropoulos^ Yes. Mike, you know we would never comment on that. I will say that as an ongoing everyday issue, there are things that come across our desk and into our business development people every day.

We look at them, we look at initially. So, it's ongoing. Some have particular interest that fit.

I would say 80% of them just -- thank you very much. This is not where we sell. This is not where we operate.

So, there are a lot of things that come into place for those things.

So, there's no burning holes that has to fit the strategy. The financial profile has to be prudent on a prudent allocation and be disciplined like we've done in the past. Again, I will defend everything we did during foundations of growth, I think was well thought out and well executed.

I think even the integration part of that were done well.

So, it's just the way that we do things, we just thought it would be good to be ready.

We didn't know what was going to happen with inflation.

So, we think that we did the right thing and that we continue to do our day-to-day work.

When something fits, we'll move. But remember, we're competing in most cases with other people. We don't have control all of that.

Raul?

Raul Parra^ Yes. I think also just to highlight a couple of things. I think a little bit of the fact that we got to was, hey, look, interest rates are going to be dropping.

We were actually believers that those wouldn't happen as fast as people were thinking and come to find out it's looking that way. Now we're not going to run a victory lap yet, but it looks like things are going to be slower than people anticipated.

So, I think that's really it. I mean at the end of the day I think we did the right thing.

We were able to leverage up and get low cost of capital, essentially leverage up, hang some cash on the balance sheet. We're earning a higher interest rate than we're paying. It's EPS accretive.

Fred Lampropoulos^ Mike, I was listening to the radio this morning, the initial, I think projections for people would see seven rate decreases this year. I heard one this morning now is one or two and inflation -- I mean I'm not an economist, but inflation almost always has two or three legs to it.

So, all that being said, that was a judgment at the time based on our feelings about things and as it all works out, I won't call it a little bit of a headwind because it wasn't -- if someone could have questioned it.

But first of all, thank you for your candor.

I'll accept your apology.

Michael Petusky^ I think I owe one to Raul because I may technically won the bet about them, not you guys not quite getting to $300 million, but I think he won the spirit of the bet. You were there.

Fred Lampropoulos^ We're usually apologizing to you.

So, we're happy to accept one on the other side.

Michael Petusky^ So, I just want to clarify one issue, and maybe everybody else gets this, but I want to make sure that I get it. Have you guys now seen all the primary endpoint data that you needed to see in terms of WRAPSODY in terms of moving forward?

Are you still waiting for some of that data would come back?

Fred Lampropoulos^ All of the patient data is in. It is being organized properly for presentation.

So, that's as much as I can say about it. But all of the data from all of the patient is in. So, that's good news for us.

And now it's the process of going through, organizing it, looking at all the various issues to make sure the protocol was fall, all of those things that you have to do now because once it goes in to the FDA, you got to have it right.

Raul Parra^ It's got to be locked in everything.

Fred Lampropoulos^ And it's got to be locked.

I think that's the process we're into right now. I think at the end of the day we remain on track, Mike, for everything that we've disclosed so far.

Michael Petusky^ Yes. Last one, and I'll get off. I didn't catch it if you made any comment around Russia in the fourth quarter. I think maybe on the Q3 call, you had suggested maybe we'll get a little incremental revenue there, but I know that's still a mess over there. And just any comment there.

Raul Parra^ I think Russia, based on everything that's going on just came in, in line with our updated, I guess expectations.

We were able to get the licenses required to do business in Russia. I think within the second hurdle, not only just getting the licenses, you also have to make sure that you're able to get paid.

So, we have a good banking partner that allowed us to make sure that we were able to receive money in the proper way in U.S. dollar and U.S. dollars.

So, I think everything worked out, I'd say the best it could under the circumstances that are happening there, Mike, but I think we were happy with how it all turned out.

Operator^ Our next question comes from Jim Sidoti with Sidoti Inc.

James Sidoti^ Now that you're close to the finish line with WRAPSODY and you finished at least enrollment with the WAVE trial, how should we think of R&D for 2024 and 2025. Are there other projects that will fill in? Or will you see that number start to come down?

Fred Lampropoulos^ No. Listen, on R&D, it's been a hallmark of Merit's history to continue to invest in projects and opportunities that we see within the budgets that we have allocated.

So, I'm going to say it's business as usual. Some products are more complicated. Some are product line extensions are improvements.

So, there's a lot of those sorts of things out there, Jim, but we're still committed to R&D. It's always been a hallmark of our success.

Raul Parra^ Yes. I think to Jim, just to add, I mean similar to what we did with foundations for growth, I mean we were able to strategically reinvest some of the efficiencies that we found back into the business. And look, I think we want to do more of the same.

As Fred mentioned, there's going to be more therapeutic products.

So, we want to make sure that we are able to fund those to continue to deliver the growth that you guys are all used to, and we've been able to deliver.

So, I think we're trying to find a balanced approach to that reinvestment and higher cost really when it comes to therapeutic products, but I think we've done a great job of managing through that, and we'll continue to do so under CGI.

James Sidoti^ So, it sounds like you think it will be made around a 6% of revenue.

Raul Parra^ I think it's fair.

James Sidoti^ All right. Then in terms of the AngioDynamics acquisition, I think you had one product moved over last quarter and another one was still yet to be moved over. Has that been completed at this point?

Fred Lampropoulos^ Yes. Everything is in place in our Mexico facility to produce our products there.

So, it's all been moved from Angio and all in place.

I think going back to giving credit, it's one of the things that Greg Fredde, who did our Becton Dickinson transfer, and you know the story there. It was done with absolute precision.

And I think we've seen the same things in this integration. We actually very candidly do it pretty well, Jim.

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

Michael Matson^ Yes. I guess just with regard to the CGI program, I apologize if I missed it, but I think you've set some operating margin targets, but I didn't see anything in there about gross margins and maybe that was deliberate on your part, but I just wanted to get your thoughts on how the margin expansion just break out between gross and operating leverage?

Raul Parra^ Yes. So, similar to what we did with FFG, Mike, we really only focused on a revenue CAGR of at least 5% operating margins of 20% to 22% and then the minimum free cash flow of $400 million.

But we didn't actually give guidance for gross margin in FFG. We did give some modeling considerations. Then I think people try to turn that into guidance.

So, I think this time around, I think we've hopefully built up enough credibility that we're going to get it from wherever we can get it. I mean I think gross margin, like I said earlier, at the low end of our operating margin, it really comes from gross margin. The high end, the 22% would really come from not only delivering on the gross margin, but also on operating expense leverage.

But at the end of the day, I think we've shown that we can get it from either operating expense leverage and or gross margin, and we'll adjust as necessary. What we don't want to do similar to what we did with FFG is get ahead of ourselves and think that we're going to be covered with just gross margin expansion to hit those levers.

And so, we'll leverage operating expenses if we need to.

But our preference is to really reinvest those dollars into the business and get it from gross margins. So, that's really our focus.

Fred Lampropoulos^ Well three years ago, we said we were going to fine-tune every aspect of our income statement and our balance sheet.

So, I think that's what we've done. So, it's not one or the other, it's all of them.

Raul Parra^ Yes. But just to give you a little bit of color, I mean it's more of the same, Mike. We're going to have network consolidation. We've got lean manufacturing initiatives. We've got better human resource efficiency, sharper on materials, logistics and everything else that we can throw at gross margin because that's what it takes.

Michael Matson^ Okay. All right.

Then just my only other question really just be around the guidance for '24 as well as the CGI, the longer-term guidance for particularly for revenue growth. I mean if I look at what you've done over the past few years, you've been more high single digits organically, and this guidance is more mid-single digits.

So, I mean I understand you're probably trying to be somewhat conservative. And I saw the call out about the SKU rationalization.

But I mean is there anything else that you would point to in terms of things that have maybe changed or something that would prevent you from being able to grow high single digits, potentially?

I mean I'm not asking you to guide there, but just wondering if there's other headwinds, I guess that you're baking in or something there.

Raul Parra^ Well look, I think when we threw out foundations for growth, I mean I think none of us anticipated all the headwinds we would have seen. I think everything in the kitchen sink was thrown in there from what everybody saw and everybody had to experience.

But look, we feel really confident in that low end CAGR of 5%. I think we think it's realistic and achievable, and it allows us to say no to certain things, quite frankly.

So, I think we feel comfortable with the numbers at 5% to 7%.

And I would just leave it at that. I think we always aspire to do better, but a minimum of five is what we're committing to.

Operator^ Our next question comes from Jason Bednar with Piper Sandler.

Jason Bednar^ Just one quick one, and you've obviously trained this all well since I don't think anybody's asked on China here.

So, I'll do it for the group. The guidance here for 2024, you're saying China revenue down due to DBP. Just more of a back check or clarification. Is this simply an extension of the DBP that we've all talked about from 2023, the second half of '23?

Or is it something new that is now developing and hitting here in 2024?

Raul Parra^ Yes. So, I mean we're not going to give additional color, but I think you're on the right track there, Jason. Again, we're not going to provide country-specific growth rates I think we called out the 4% decline in the APAC region, of which most of it is related to -- actually all of it is related to China.

But I will say that we continue to expect volume to grow on a year-over-year basis.

But obviously, we are seeing a decline due to the continued headwinds related to volume-based purchasing. And it's just something that we've been managing through over the last several years, and it's baked into our 5% to 7%.

Operator^ I'm showing no further questions at this time.

I would now like to turn it back to Fred Lampropoulos for closing remarks.

Fred Lampropoulos^ Well, again, to everybody, thank you for joining us today. It was a long call with a lot to cover.

We appreciate the questions and the opportunity to present to you. Just in closing, a reminder that we put our shoulders to the wheel. We worked hard.

We had every single employee in this company aligned with the company objective, department objectives and individual objectives.

So, we are all aligned as a company, and we expect to be able to deliver exactly what we said over our next three-year program, which we didn't have to do.

We felt it actually helped us. We believe being on the line and being accountable is the right thing to do, and we'll look forward to reporting to you in the future. So, best wishes from Salt Lake City.

Just a quick reminder, the SIR meeting starts in late March, is being held in Salt Lake City this year. It's Merit's biggest show we hope you get a chance to go out here and take a look at Salt Lake, the SIR meeting and even maybe an opportunity to come to merit.

So, best wishes and good night from Salt Lake City.

Operator^ That does conclude our conference call for today. Thank you for your participation.