

March 24, 2017

Dear clients and colleagues,

In early February, we attended the 2017 Leerink Swann Healthcare Conference in New York. The conference allows us to meet various companies while also providing access to thought leaders in the areas of policy and science, thus making this a key event for the health care sector.

With the Congressional Budget Office attempting to repeal the Affordable Care Act, for the time being US health care remains on hedge. Preliminary numbers show a reduction in Medicaid spending of \$880B over the next 10 years as it predicts that 14M people in 2018 and up to 26M people by 2026 will no longer be insured. To offset the expense cut, health care corporations will benefit from \$600B in tax reductions over the next 10 years. Estimations are that Medicaid premiums will increase 15%-20% in 2018 and 2019 and then stabilize. Because of the number of insured that will lose their insurance, fierce and lengthy negotiations are expected within the Republican Party.

The medical device environment should remain favorable policy-wise in the coming years with former orthopedic surgeon Tom Price at the helm of Health & Human Services. According to analysts, fewer regulations, faster approvals, better reimbursements and the repeal of the medical device tax could all be on the horizon.

One area that proved to be quite fascinating at the conference was medical robotics. The sector is not new. Intuitive Surgical has certainly proven that robots are abundantly useful in a surgical suite. The company has a market cap of \$26B and its devices have been used in 750,000 procedures annually, with 34,800 units in urology, gynecology and general surgery suits. For thoracic and abdominal procedures, Intuitive Surgical will be hard to compete against as the system helps surgeons automate in hard to navigate body cavities under minimally invasive settings. Benefits of robotic surgical assistance are reduced length of stay, fewer conversions to open surgery, reduced complications, fewer re-admissions and lower infection rates.

The pace of change is occurring rapidly. Carl Zeiss Meditec, a long-term holding at Global Alpha, recently replenished its acquisition war chest in anticipation of making acquisitions in the area of surgical ophthalmology. The company raised 317 million euros in a highly oversubscribed share issue. The company already leads in the ophthalmology surgical equipment field with automated equipment such as the ReLEx Smile vision correction system. The ReLEx Smile procedure is the least invasive, safest and fastest vision correction procedure on the market.

Orthopedic surgery requires different skillsets, such as perfect anatomical positioning, this should help new entrants in robotics keep industry-leader Intuitive Surgical at bay. At \$222M in 2015, the orthopedic robotics market is in its infancy; however it is expected to reach \$5B by 2026. Two things tell us that the orthopedic opportunity is real: the benefits are consistent to thoracic and abdominal procedures and the orthopedic

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industry is already highly tech savvy with prevalent usage of software guidance systems that allow surgeons to optimize alignments.

The innovators in orthopedic robotics are Stryker (hips and knees) and Medtronic-Mazor (spine).

Touted as a difference-maker by certain orthopedic surgeons, Globus Medical will be the second sales and marketing organization to enter the robotic spinal surgery market with its device set to launch in 2017. We recently initiated a position in the company.

We have met with Globus on several occasions over the years and have always been impressed by its industry-leading 30%+ margins. These margins are driven by a well-managed and nimble company from R&D to sales. Globus has launched over 150 new products since its inception. 2016 was a difficult year for the company as a lull in new product launches triggered the exit of some of its sales force. However, 2017's new products should reinvigorate the company's marketing and sales efforts.

Globus Medical Inc. (GMED, \$29.6)
www.globusmedical.com

Business Overview

Globus is an orthopedics products manufacturer focused on spinal surgery, addressing traditional open surgery, minimally invasive procedures and new interventional treatments (motion preservation, total disc replacement, advanced biomaterials technologies). The company has 1,200 employees, including staff in RD, production, sales and marketing.

The company has research and manufacturing facilities in Massachusetts, Pennsylvania and Texas and leased research and manufacturing facilities in Texas. It also owns a distribution centre in Heerlen, Netherlands to support international operations. Sales and administrative offices are situated in twelve countries.

Revenue mix by product:

- Innovative Fusion: 50%; growth +3%; \$276M; pedicle screw system and multiple other products.
- Disruptive Technologies: 50%; growth +6%; \$275M; minimally invasive, biologic, artificial disc, and interventional pain management products.

Revenue mix by region:

- US: 89%; 2% growth.
- International: 11%; 35% growth. Innovative fusion products (pedicle screw, body systems) growth occurring in existing regions. Geographic expansion occurring in Europe, India, South Africa, Australia, South America and The Middle East.

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Investment Theme

- Demographics, health care cost controls, transfer of surgery out to specialty hospitals.

Target Market Size

- Global spine market: \$9B and growing at 5.6%. Globus holds a 5% share of the market.
- In the US, 1.34 million spinal operations are performed annually; worldwide there are 4.83 million performed annually. In 2015, 11 million people in the US and 78 million people worldwide suffered from chronic back pain.

Competitors

Medtronic has sales of \$2.4B and is growing at 0.5% while Johnson & Johnson is at \$1.32B. Globus is gaining market share with 9% projected growth in 2017 on \$564M in sales.

Growth Strategy

- Grow international sales at a rapid pace.
- Introduce new products; surgical robots in 2017, trauma in 2018.
- Short term: return to aggressive hiring practices, emphasis on sales growth and territory development, manage sales rep retention rates.

History

- Founded: 2003 (incorporated in Delaware).
- IPO: 2012 (9.58 million shares at \$12.00 per share).

Management

- Insider ownership: Management 3%.
- Co-Founder CEO: David Paul (14 years); various positions at Synthes; Biomaterials Engineer at Temple University; named inventor on 45 patents (several others pending).

Have a good weekend.

The Global Alpha Team

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