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CORPORATE PARTICIPANTS

Brian G. Lloyd *Merit Medical Systems, Inc. - Chief Legal Officer & Corporate Secretary*
Fred P. Lampropoulos *Merit Medical Systems, Inc. - Chairman, CEO & President*
Raul Parra *Merit Medical Systems, Inc. - CFO & Treasurer*

CONFERENCE CALL PARTICIPANTS

Jason Richard Mills *Canaccord Genuity Corp., Research Division - MD of Research & Analyst*
Jayson Tyler Bedford *Raymond James & Associates, Inc., Research Division - Senior Medical Supplies and Devices Analyst*
Lawrence H. Biegelsen *Wells Fargo Securities, LLC, Research Division - Senior Analyst*
Matthew Oliver O'Brien *Piper Jaffray Companies, Research Division - MD and Senior Research Analyst*
Michael John Petusky *Barrington Research Associates, Inc., Research Division - MD & Senior Investment Analyst*
Robert Adam Hopkins *BofA Merrill Lynch, Research Division - MD of Equity Research*
Steven Michael Lichtman *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by and welcome to the MMSI Third Quarter 2019 Earnings Call and Slide Deck. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions)

I would now like to hand the conference over to your speaker today, Fred Lampropoulos, Chairman and Chief Executive Officer. Please go ahead.

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

Good afternoon, ladies and gentlemen. This is Fred Lampropoulos, Chairman and Chief Executive Officer. We are gathered here on a cold, wintry afternoon in Salt Lake City, and we want to thank you for joining us. To begin with, we'll have Brian Lloyd, our General Counsel, read our safe harbor provision. Brian?

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

Thank you, 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, which are 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 in 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. Additionally, 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 once again, ladies and gentlemen, thank you for taking the time to join us.

Today we're going to outline first of all how we'd like to go through our discussion. A reminder that we have a slide deck that is on our website that you can view that will give you more insight into some of the products and opportunities that we're going to discuss today.

To start out with, I'd like to talk about the third quarter just in general terms. As many of you will recall, this is the summer quarter. And we are always concerned about the summer quarter each year, and it's for good and varied reasons. Particularly is really the slowdown in procedures, and even so far as countries that literally shut down. And so it's always a difficult one for us to predict and to discuss.

Now that being said, we will -- there were some other events such as a competitor that we got a bump last year, but rather than to linger on this, I'm going to turn the time over to Raul in just a moment to discuss sales and earnings and some of these specifics. Then we're going to come back. I will go then and talk about a number of items that we have accomplished in the third quarter. And many of you will recall in some of our previous meetings in New York and other locations that we wanted to talk about things that we have accomplished; not things that we're thinking about. We'll then come back to Raul for guidance. And then I'll talk about the new products and talk about other issues I think you'll be interested in.

The theme of our call today, as is the theme for the company staff retreat and planning session that's also going on this week in Salt Lake City, is back to basics. And I think that's very, very important for everybody to consider as we talk and contemplate the things that we think are necessary to be able to bring the performance that all of us would like to have. With that being said, let me turn the time over to Raul Parra, our Chief Financial Officer. Raul?

Raul Parra Merit Medical Systems, Inc. - CFO & Treasurer

Thank you, Fred. Revenue for the third quarter was approximately \$243.0 million as reported, an approximate 9.6% increase over the comparable period of 2018 and approximately 4.3% on an organic constant currency basis. FX headwinds were approximately \$2.4 million. The FX winds are mostly from the euro and CNY and emerging markets.

Additionally, the following products continue to be behind our forecast for the year: Aspira by \$3 million; DFINE by \$5 million. Acquired products contributed revenue of \$14 million with Cianna and ClariVein contributing \$11.6 million and \$2 million, respectively. Both Cianna and ClariVein fell behind by \$4 million and \$3 million, respectively. We continue to be high on Cianna, and a portion of the miss is due to the delayed CE Mark clearance.

Contribution from our sales divisions to our OCC were as follows: worldwide dealers at 17%; U.S. direct at 3%; Sensors at 2%; Endotek OEM and EMEA declining 9%, 2% and 1%, respectively. In addition, during Q3 we also had an abnormally high revenue recognition adjustment amount as compared to prior quarters. In relation to our most recent quarter, Q2, this amount was higher by approximately \$4.6 million. Had we been able to recognize this amount, our OCC would have been 6.4% for the quarter and OCC for EMEA would have been an increase of 10.2% instead of the decline at 1%. Normally we don't comment on our revenue recognition because it's not a material adjustment from quarter to quarter, but in this case, the adjustment was significantly higher by a factor of approximately 3x than in other periods and felt it was necessary to call out.

Gross margin on a non-GAAP basis was 48.1% in the quarter. On a performance basis, gross margin was down 170 basis points compared to the comparable prior year quarter and flat year to date, both clearly behind our expectations. This reflects the margin decline in the quarter as compared to the prior year, which was negatively impacted by FX, tariffs by 20 basis points, freight and manufacturing variances of 100 basis points -- 150 basis points, sorry, and offset by a favorable product mix of 65 basis points. The 2 largest components for reducing our expected product mix were our DFINE and Aspira sales, which accounted for 38 and 46 basis points, respectively. Cianna and ClariVein continue to help our product mix, which for the quarter was 112 basis point favorable contribution.

OpEx. Our Q3 operating expenses were approximately 38.9% of revenue on a non-GAAP basis. Expenses were up mostly related to hiring in anticipation of higher revenues, which did not play out as previously discussed. The hiring started in Q2 and into the first month of the



third quarter. During our Q2 call we called out what we would not be waiting around for things to improve, and we would immediately start looking at ways to improve our operational efficiencies. We're going to talk about that here in a little bit. I'm going to let Fred talk about what we've already done. I'll just finish out with a few more things here.

Tax rate on a non-GAAP basis for the quarter was 20.8% compared to 19.4% for the comparable period. Again, it was driven by stock option exercises.

EPS non-GAAP earnings were \$0.28 for the quarter as compared to \$0.47 for the comparable period. EPS was below our expectations as a result of the lower than expected revenues, gross margins and higher operating expenses and FX headwinds.

A few other items for everyone. Debt balance was \$441 million with a cost of debt of approximately 2.9%. And our leverage ratio was 2.78% on a gross basis and 2.55% on a net basis. The change from Q2 was driven by continued payment of \$50 million for Cianna and 2 minor acquisitions totaling \$17 million.

Working capital was \$288 million, CapEx for the quarter came in at \$22 million, D&A of approximately \$23.5 million and stock comp expense of \$2.6 million. Fred, do you want to touch base on what we've --

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

Yes. Thanks very much. Well, I think as all of you can see that if we take a look at really the last 2 quarters, it's been a tough time. But I make a comment in my note that we've been through the trough. Now some of you say, well, we've heard that before. When I get completed -- or when I complete the discussion about the things that we have done, Raul will then go through the guidance. And I would ask you then take a look at the year-end guidance and the things we're doing and then measure that against where we are at the end of the third quarter and will really show the improvements that we believe you'll start to see. The essence of what I'm saying is we have hit the bottom of that trough. We have taken actions. And let me tell you what some of those are because I think they're significant.

First of all, we have reduced our global headcount by 2% in the quarter. That's about 150 employees. And that's never very much fun, but they were at the what I would say -- I'm not going to say non-essential because everybody was essential, but as we were planning hire growth, you hire to staff that, and when that doesn't come, then you have to adapt to the conditions. And so we have made those permanent changes.

We have a contingency plan to go up to 5% if necessary. Now I don't think that will be necessary. There will be some future adjustments. But I think the net of what I'm saying is that we need to get leaner, and we have done and taken I think some steps already to take -- to put that in effect.

We've shut down our San Jose facility in California, and that was an R&D facility. And that's part of this 150. It was part of the DFINE acquisition. There were certain R&D activities going on there. We took the essential items and moved them here to Salt Lake City without any additional hires here and have closed that down, and that will be a permanent cost savings. As we look at this in the aggregate, it's about \$15 million in the quarter on an annualized basis of expense reduction. And so when we talked about things we're going to do, we haven't been sitting by passively. We've been very actively looking at that.

In addition to that, we are watching very carefully those discretionary expenses. Things like travel, things like trade shows. The things that cost a lot of money will go to the things that are absolutely necessary. In fact, this evening I will be traveling to San Diego to attend the CiDA meeting, which is a hemodialysis meeting. And there are things that we need to do and we'll continue to do those. But those things that we would like to do versus the things that you need to do, and so I think we're watching these things very, very carefully.

In addition, there are additional satellite facilities that we will either consolidate into our Texas, our Mexico facility or here in Salt Lake. We intend sometime in the first quarter to consolidate another facility here in Salt Lake. And so we have an active plan of doing things to help permanently reduce costs, become more efficient, and all these will have an effect on the bottom line.

So there is no question that as we look forward into the fourth quarter and into next year that we will have lower costs. And again, I

understand that when we talk about these things, everybody has to look backwards and report on that. I hope what comes out of this is people understanding of the things that we have done, new products and those things that we'll talk about in a moment, and why we believe that the path forward will be much better than where we've been in the last 6 months. And that's really, if there's a message to come today and questions, I hope those are the things that we can talk about. I'll be happy to discuss the second -- or excuse me, the third quarter, but again, as you all know, there were a number of circumstances. And without trying to blame or all this and that, everybody understands things like FX and tariffs.

And then we'll also announce -- I'll turn some time over now to Raul who will talk about guidance and 2020 a bit, and then we'll come back and I'll talk to you why we're still continuing to be very optimistic about the business and the things that we're doing today. Again, I have to report on the past, but I have to live in the present and look to the future. So Raul, with that said, let me turn that time over to guidance and where we look out for the future.

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

Yes, Fred. Yes, I think unfortunately our guidance doesn't reflect how excited we are about what we've done and how the future looks. But needless to say, let's get that out of the way and then we'll talk some more about additional items we want to hit on.

So our updated Q3 guidance for 2019 is as follows. We're adjusting for the FX headwinds that we continue to see in the euro, CNY and the emerging markets, that change in our product mix and our acquisitions. Our revised guidance for revenue will be in the range of \$986 million to \$995 million, which includes the following. We will bring down our non-core from our previous guidance of \$62 million to \$66 million to \$52 million to \$54 million. Non-core revenue, as you guys are all aware, is Cianna, ClariVein, Becton Dickinson, NinePoint and a few other minor acquisitions.

We estimate our core growth on a constant currency basis for the year will be approximately 7.5% to 8.5%. We will adjust our reported revenue for FX. The range is now \$14 million to \$15 million for the year.

I want to make clear that the guidance does not contemplate our fluid administration contracts.

Gross margin on a GAAP basis will be between 43.2% and 43.6%. Gross margin on a non-GAAP basis will be between 48.4% and 48.7%. The change in our margins is coming from what we have seen year to date, which is FX headwinds, tariffs and a demand on our legacy products which have lower margins than our corporate average, along with the -- which leads into the unfavorable sales mix.

With the current operating efficiencies that we obtained, we estimate our OpEx as a percentage of revenue to be approximately 36% for 2019.

Interest expense of approximately \$12 million to \$13 million, which updates the forecast for current market outlooks on interest rates.

Our forecast still includes a tax rate in the range of 22.5% to 24.5% for the year.

Earnings EPS GAAP will range between \$0.27 and \$0.33 for 2019. On a non-GAAP basis, the range will be between \$1.40 and \$1.46, which contemplates the FX headwinds of approximately \$0.04 to \$0.06. The change to sales, our gross margins and the related product mix that we're seeing and the operating expense that we've had and also the operating efficiencies that we expect to see in the fourth quarter.

Fred?

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

Okay. So let me talk about, again, where we're heading. We've talked about what we've completed and the challenges that we've had. And I don't think I need to discuss that at least in my comments any further. What I do want to talk to you about are things that we've also talked about and we think are important.

First of all, we're going to take 2020 guidance off the table, and let me tell you why. We want to make sure that we can reset the expectations to things where we don't have to do this anymore, and that is change. We think we now have enough visibility and understanding, except for the business that comes with the Premier and a preferred provider opportunity that we're engaged in. We are seeing that progress, but remember it was summer, and there are things that have to go through to be redesigned. It has to be -- people have to be trained. So that is moving forward, but we thought there might be something that might come in the third, maybe the fourth, but reality is it's a 2020. However, in this quarter we're going to get better visibility as to what that means.

And it's a good opportunity for us, but we want to make sure we get the numbers right and make sure that we don't overestimate them or underestimate them. So we think it's best to finish up this year. And again, I would invite you to take a look at the guidance for this year. Take a look at where we are through the third quarter, and it will show you the improvement we're talking about. And then we'll move forward into next year in this mode where we think we're, again, back to the basics.

Couple of things that are working. We continue to work for the CE Mark approval with the Cianna product. I personally flew to Norway to meet with a notified body. I think that dialogue helped to open up a really good relationship and understanding. I am reasonably optimistic that we will have that done by the end of the year. And we are prepared to open that market immediately. We are prepared to do that.

I want to remind everybody that as far as Becton Dickinson is concerned, and I made a comment about this in my prepared notes, that we have completed what was arguably the most difficult transaction in our history. 6 sites, 2 companies, several countries. And we are now up and running product. Essentially everything that was in that transaction is now being built in one form or the other at our facility in Tijuana.

Let me go on to some other things that I think are really important, and that is as we look forward, we talk about this robust pipeline of products and growth. And there's a list. There's probably just as many names as I could also put in there, but you'll note that I put over the next 6 months. These are just the new products that are coming out that were all developed internally.

So one of the things you'll see as we come out and we start to give you our forecast in 2020 as we report the full year is you will see that we'll essentially be at core growth on everything. So the essence of that is we are really slowing down -- I'm not saying we couldn't do a transaction, but our focus is on the business as it sits and the opportunities that exist. Not trying to go out and do another deal. Again, just as I say that, something may pop up, but we're not actively seeking those kinds of transactions at this point. We think the important things are is to reduce our debt, to make sure that we can improve the efficiency of the business, and introduce these new products.

I also talk about the Rhapsody. We have finished the first in man. It's a significant accomplishment. We are meeting with the FDA, and we have in fact filed for breakthrough technology designation. It's kind of a big deal. And we hope that sometime in the late first, early second that we will be able to have approval from the FDA to initiate the IDE that moves on to then the PMA and the pivotal trial for the Rhapsody stent delivery system, and we think this is very, very important.

So as we look at where we are, we're humbled. We are engaged. We have a full pipeline. Nothing is stopped in the R&D process except for a few things, and let me explain those to you. One of the things that we've talked about is it is our intention to be able to leverage all aspects of the income statement. So we do expect going forward that we will be able to show you improvements in gross margin. We do believe that we will have less SG&A cost, and that has been something we've held onto and invested for the last several years, as well as R&D costs. So instead of being a percentage of sales, we're going to manage this so that the bottom line is that we get a higher operating profit and a higher earnings per share. That's our goal, that's what we're working on, and again, the entire business is totally engaged in this process.

So I don't believe that it's ever pleasant to go through these things, but like any humbling experience in any of our lives or businesses, there's actually very, very good things that come out of here. So again, I hope that where we end up is that you've looked at the past and say, okay, and make your judgments on that. And we intend to show to you and prove to you the things that we've done and more things that we will do to help get the performance, better cash flows, reductions in CapEx going forward, better margins, new product introductions and the kind of performance that we're capable of.



Now we are -- lest anyone think that we're not enthusiastic about it, it's like Raul said early on in the call. You have to talk about these things, but it does not dampen our enthusiasm. In fact, to be very honest with you, as we looked at it and we looked at the quarter, we said well that was -- it's like you lost a game you should have won and we didn't. But now it's the new week, and some of you say, well, I don't know if I believe that. You get to decide that. But just let me again reiterate the commitment that we have as a company, and not just me, but the entire staff to execute and bring back that issue of performance, hitting our numbers and doing the best we can to exceed them. Now I know that's an odd conversation to have when we're having this quarter, but my job is to look forward, make assessments of our failures and make sure that we plan for success.

So ladies and gentlemen, that's all I have today. We've been on with you now for about a half an hour. Raul and I will be here for the next several hours if you need us.

And one more thing. I'm sorry, I've got to talk to you about this. Net sterilization. I make a few brief comments about it, but I want to let you know that we are in good shape as far as sterilization. We have backups to each of our sterilization sites. Either they're approved or in the process of being approved. And as I point out in my notes, we also have -- I think there's a number of opportunities because I think there will be some shortages. A number of notes that I read this week coming out from different analysts and different industry review groups have talked about these particular situations. As part of our enterprise risk management system, this is something we identified some time ago, and we have things in place and so that is not a risk. Although as capacity shrinks, that'll be a challenge for everybody in the medical device area, but we're in very good shape there as of this call.

So with that being said, I will go ahead and turn the time over to our administrator, and we'll look forward to your questions. Thank you again for attending, and I will turn the time now to the administrator. Let's go.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Jayson Bedford with Raymond James.

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

Just a couple quick questions. I guess first, just for clarity, the fluid management contracts, you didn't recognize any revenue in 3Q and you don't expect to in the fourth quarter as well. Is that correct?

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

No. Jayson, thank you again for the question. What -- we are just starting that process. We have actually had a few conversions, and there are a lot of discussions and planning, and by that, I mean people have to use up their inventory. We have to go configure structures, send prototypes out for approval. It's a process. And so it is moving along, but nothing of any significance. We'll see really the major part of that coming in next year.

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

Okay. And you mentioned the release the preferred provider status with a major vent device distributor. Is that just for fluid management, or are there other products included?

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

They're a current customer, and we sell a lot of standalone products. So there are many of our safety products that go into that, things like our BackStop, our safety scalpels and syringes. So there's a lot of products that go into that arena. But the primary purpose of that agreement, the biggest change we've -- we've always provided these guys, but we've not been the preferred. Now with the other situation where Angio sold off theirs to Medline, it creates an opening for Merit, and we have executed an agreement with that company.



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

Okay. And maybe just a bit of a bigger picture question, Fred, you know at this stage of the business where you're having to cut some costs here. Are you comfortable that this cost cutting will not impact your historical organic sales growth?

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

Well, you remember we have a lot of big numbers to deal with, and we have a lot of other issues like you have in China where they're looking to do preferred types of things on a national basis. So those are things that are more organic. But I think that in terms of capacity and looking at what we're doing, we still have capacity in all of our facilities. We have a new facility coming online where we're consolidating one that we rent into a new technology center across the street. That'll be ready in December. And I think our operations group continues to do the lean manufacturing and taking products that come out of R&D that are really -- and no offense to my R&D guys that are sitting in the room here, but theirs is to develop products and get them into production, but the efficiency part of it really comes out as we get more volumes and it goes to operations department. So these are things. This morning at 6:30, 5 of us met to talk about a specific situation and making sure that we're wise. So again, there are a lot of parts to this. We want to make wise decisions and make sure that we have the capacity. We don't want to do anything foolish that we would regret. And I think we have enough experience, Jayson, to make sure that we do make the right decisions in terms of capacity or consolidation. We've done this for a long time, and I think we'll be fine, and I think you will see that we will do these correctly. Like I said in my comments earlier, the San Jose one was easy. There was essentially no production there, and it was an R&D facility and it just was not being productive. So again, just some color on that.

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

I guess what I'm just curious, though, is off a lower cost base, do you still think you can grow this business in the let's call it 7% to 9% range on the top line?

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

I'm going to let Raul answer that, but I have an answer. Go ahead, Raul.

Raul Parra Merit Medical Systems, Inc. - CFO & Treasurer

Well, I think Fred referenced our strong product pipeline. I think as we look out, I think -- I don't want to -- we took 2020 off the table, so I'm going to be careful not to give any guidance, but I think we're feeling optimistic about our pipeline. Again, I think we have to understand some of these moving parts. But we still feel very strong about the business.

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

And I had him say that, Jayson, because I always feel positive about sales and marketing and growth and those sorts of things. So the answer is, yes, we do.

Operator

Our next question comes from the line of Larry Biegelsen with Wells Fargo.

Lawrence H. Biegelsen Wells Fargo Securities, LLC, Research Division - Senior Analyst

I wanted to ask about the growth outlook implied in the guidance. But one high level question, Fred. I guess the question is how did we get here? It seemed like last year things were going so well. And it seems like, frankly, a lot has gone wrong this year. So I don't know, Fred. Operationally, anything you think you need to change? How do you think you got to this place?

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

Yes, I think there were a couple of things, Larry. Of course we can't dismiss the items like Brexit. We went and built a facility in Great Britain. That cost money and takes time, but we felt we needed to do that. If you take a look at a couple of OEM customers, we had a large customer last year doing over \$8.5 million at high margin. This year is \$1.5 million. We didn't know where that would come into play, but it didn't come back. We thought it might. We also had another player where we were building a vena cava filter. And again, I don't want to identify the companies, but these were OEM. So if you take that one and just the other OEM customer alone, it was somewhere around \$10 million or \$11 million, \$12 million of revenues that we thought would come into play, and they were high margin.

So that affected it. I think if you take a look at the dollar, and again, these sound maybe esoteric, but when you have a strong dollar, you have the world crisis, we did not get the revenues that we thought out of our distribution channel. That is starting to come back. We've seen it. One of the orders that we've talked about that was deferred was going to the Middle East. It was shipped. And there are more orders coming from the Middle East. We have a lot of activity that was rather quiet in the second and third quarter, so those are coming back now. And that's why I think as we look forward, we look at those. Now, let's go to -- because this is -- we can spend a lot of time on this. If we go to the acquisitions, we thought we did the right thing in terms of keeping the Cianna sales force in effect. We still believe that way. But just the integration of both the Becton Dickinson, the Cianna, the Vascular Insights, all of these things just caught up with us. And we thought we were Superman and we found out that we're human. So I think looking at where we are today, on Vascular Insights, we beat the previous quarter. So the third quarter, even in the summer which is the slowest quarter for that year, beat the previous quarter by over \$400,000 in revenue. So I think that will be on track, but it's 9 or 10 months behind where we thought it would be. So there are those factors that came into play that had to do with the, I think the instability of the marketplace, and as it pertains to our products, our own overestimation and forecasting. So I think there were a number of factors, and you all add them in here, Larry, and we are where we are today. Now all of that being said, we didn't stop our R&D projects. We've continued to progress that pipeline. We put a bunch of new ones up here on our slide deck, which we would refer you to, which will be coming forward. And just 10 minutes before this call took place, we had a physician call -- and we're sitting here. There's 40, 45 people here in the room. And we had a physician talk about a trial that he did today where he utilized 3 new devices, and he gave us glowing remarks and wanted to take the time to call us. So back to the main part of the question. There were a lot of factors, some in our control and some not in our control. And again, as I've said, I know you guys have to go back and report and then try to make an assessment of are there guys going to have another quarter like this, are you going to do this, are you going to do that? You guys are going to have to make those calls. But I think we feel like we have the business under control. We understand where we need to go. We have the plans and promotions and things to put in place to meet our obligations and our commitments and our forecasts going forward from here. So that's the best way for me to answer that. Go ahead.

Lawrence H. Biegelsen Wells Fargo Securities, LLC, Research Division - Senior Analyst

That's very helpful. Now I just wanted to focus on the future outlook. Raul, if I am doing the math correct, is Q4 the implied organic growth about 8%? And what drives the acceleration versus Q3? And the gross margin also, Raul, it looks like if I'm doing the math right, the midpoint's about 50% from 48% or so in the third quarter. What drives that? And I guess just lastly -- and any color on 2020. It sounds like you still think this business can grow call it high-single digit. Any other color for modeling, for updating models today? And I'll drop.

Raul Parra Merit Medical Systems, Inc. - CFO & Treasurer

So we don't provide quarterly guidance, but I think if you're looking at our, I guess at the midpoint, we feel like the 7.5% to 8.5% that we provided for the year should provide you a good base to calculate what the fourth quarter is. Now obviously there's going to be a low number there and a high number. I think the -- obviously, we hope to end somewhere in the middle there for the year. As far as the gross margin, can you repeat your question there? I was looking at the --

Lawrence H. Biegelsen Wells Fargo Securities, LLC, Research Division - Senior Analyst

Yes, it looks like -- sorry, I asked a multi-part question. It looks like again the guidance implies a sequential improvement about 50% at the midpoint, if I'm doing the math right, from 48% in the third quarter. I'm just curious what drives that improvement. And just to make sure you heard the whole question, I'm sorry again. Any color commentary on 2020? I know you're not -- you've retracted the long range guidance, but on the P&L, any color commentary would be helpful. Thanks again.

Raul Parra Merit Medical Systems, Inc. - CFO & Treasurer

Yes. So the gross margin I think we have obviously some cost reductions that we did that are going to feed into that. We also had some headcount reduction. If you look at the guidance I think -- and you calculate it out, you might get to a slightly different number on the low end where it doesn't grow sequentially. But take a look at it. We think we're in the, on the year-to-date basis, we're pretty good, and we feel comfortable based on the cost cutting initiatives that we did. And obviously, we'll have increased revenue sequentially, which will also help on some of our fixed costs. As far as 2020, I think we're going to provide that guidance when we release our fourth quarter numbers. I just think with all the moving parts that we have going on, I think we think the prudent thing to do is to just wait and make sure that we deliver accurate guidance that we can meet or exceed.

Lawrence H. Biegelsen Wells Fargo Securities, LLC, Research Division - Senior Analyst

Fair enough.

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

Larry, let me jump in on the fourth quarter just to add a little color. We launched a number of new products. We're seeing that those -- these are embolic products. Our EmboCube, our Torpedo. We have the ConvertX that's out there. We have the PhD. So we have a number of products that are showing very strong growth and momentum and enthusiasm from the sales force on the newer products. So I think we feel -- again, that's what we were trying to do here today is to get to a point where we have confidence in the numbers and the delivery, and unfortunately, with the summer, that's a very, very difficult thing to do. I wish we would have been wiser. But the bottom line is I think we do have that level of confidence. And I think in terms of cost overall, and again, I think the beauty of what we try to do with our call is everybody's sitting here. And we've had a staff retreat this week. We're looking at the things that we need to do. But even on the staff retreat, I just have to share this -- and Larry, thank you. Rather than bringing everybody in from all over the world, as an example, what we did is we ran a virtual meeting, a WebEx with all of the various parties and with the Salt Lake people and literally saved hundreds of thousands of dollars. So I think that we're looking at those things and saying, how can we do this differently and more efficiently and still have the same type of information that's made available? So there's a lot of things that we're doing that I think are all right on the mark. And one might say, well why didn't you do those before? And I think Raul mentioned that and that is you build in anticipation of meeting the demand, and then when it doesn't come in there's a lag. But I think we've responded very, very quickly in terms of -- or as best as we can to make these adjustments so that we can feel confident in the future at this point.

Operator

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

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

I guess just for starters, when I look at Q3, we're a little bit short in the top line. But the Q4 number's about a \$15 million cut to what you had been expecting, so that's pretty meaningful. And I know Cianna's part of it, but I think it's just a sliver. What else is coming out of Q4? Seemed like standalone in catheter is pretty weak this quarter.

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

You want to go ahead and hit that one?

Raul Parra Merit Medical Systems, Inc. - CFO & Treasurer

Yes. To be honest with you, Matt, it's a little bit of everything. I think we've cut our outlook for acquisitions. So you've got Cianna that's going to impact that. You're going to have ClariVein that's going to impact that. NinePoint's a little slow, too, so that's impacting it. Biopsy -- or sorry, not the biopsy. Biopsy's doing great. Drainage is struggling. So we've got those factors built into the guidance. And I think it's really just making sure that we thought through all the inputs. And also there's some FX, too, that we were hoping that FX was going to get a little bit better. It didn't. The CNY seems to have stabilized a little bit in that 7.06. It hit even 7.05 today, which helps us. I just think we tried to think through all those things that quite frankly we should have caught in Q2.

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

Okay. So taking out virtually everything you can think of that possibly could go wrong in Q4 for the guidance that you provided for the rest of the year.

Raul Parra Merit Medical Systems, Inc. - CFO & Treasurer

Plus the positive things we were thinking of right now. It's not all doom and gloom.

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

I think that's a fair statement.



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

Okay. And then I'm a little surprised by the reduction in the outlook for Cianna based on the CE Mark. I know there's an opportunity with that product. It just seems like there's a lot of interest here in the States. So it feels like something else is going on there that maybe the integration has had a little bit of a hiccup or something along those lines because I would have thought Cianna would do a little bit better than it has so far.

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

I'll take that one. Matt, in terms of all of the SG&A expenses and all that stuff, that's all integrated. In terms of the manufacturing of the consoles and all of that work, that's all integrated in Salt Lake City. We've been spending our time, and I made comments previously that we have almost 40 KOLs in Europe who want this product. It has been, very candidly, very disappointing. And it's unfortunate I had to fly all the way to Norway to sit down with the president. But we thought we'd have that in January. But I think maybe the more important part as we look forward is that we are prepared in all of the countries in Europe. We're waiting for approval in Saudi Arabia. We've done cases in Singapore and in Hong Kong. So we haven't lost our enthusiasm for the product, and we would agree with you. But remember historically, and maybe this is where we should have applied our knowledge generally of the facilities over the summer that the slowest time of the year for Cianna is always the biggest slowest time of the year. And then also the capital cycle. And again, as we went through this transition there was all this stuff in the pipeline. A transaction is disruptive, and it takes time for all of that to take place. And I think now we're starting to see that come back. And just those monitors really drive that disposable use. So again, we haven't lost our enthusiasm. And again, I think on everything we've been talking about, please be reminded as we do every year, the third quarter is always a difficult quarter, and the new products we acquired had that same struggle as well. So that's one of the reasons why we're optimistic going forward. We've already seen increases in interest and order levels and production, and all of those things are moving the way we would expect them in what is historically one of the 2 strongest quarters of the year. So that's the best way I can answer that.

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

Okay, that's helpful. And then just on marketing real quick. I think you said you cut about 2% of the headcount at this point, and there's the potential to go up to 5%. When might you make that decision as far as when you could do that? And then I think you said it's a \$15 million annualized savings. Is it a linear type of a savings if you go up to 5%? So it'd be something in the \$37 million savings range if you were to decide to do that?

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

You know, since we haven't selected where all of those are, I don't know how linear it is. So I'm going to just kind of not -- I don't know how to answer the question there. But let's talk about the decision making process. These things are complicated. And some things will go to Mexico, some products will go to Texas. And we're meeting and looking, and we will make some of those decisions before the end of the year, but they'll be implemented after the first of the year, so I wouldn't be surprised if we didn't see some decisions made. But you'll really see the effect of those, maybe some in the fourth quarter, but not likely because it's not a very -- we've got 2 months left and holidays. But probably in the first quarter of next year they'll actually take effect as we make those decisions. Now some of those may take several months to reduce those headcounts and those consolidations to make sure that we have inventory. Remember, these facilities and these locations, places where we're making product and selling it to customers, and we can't afford to miss a beat there. So we have to essentially duplicate. It's a complex process, but let me just assure you that we're well engaged in this conversation every day. So look at all the aspects of the business in any location. This isn't just the U.S.; it's Europe. And during the quarter, Raul and Ron Frost and I, our Chief Operating Officer, were in Europe looking at things at all of our facilities there. So we have been making assessments of all of the opportunities. Raul, you want to add something.

Raul Parra Merit Medical Systems, Inc. - CFO & Treasurer

I think, again, we don't -- we want to make sure that the growth pattern that we've had historically remains, and we just want to make sure that we're cautious. We're not going to do any knee jerk reactions here. We want to be focused. I think the kind of the mantra is we want to make sure that when we're looking at the cost that, 1, it's going to be attainable for whatever target we reached, and that also, 2, it's sustainable over a period of time. So I think we want to make sure that we're not going to do something that we're going to regret, and then we're having to spend additional money 3, 4, 6 months from now because we made the wrong decision and we made it too fast.

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

And let me just add some more color to that. A number of years ago, 10 or 15 years ago we made some decisions, and we actually took too much meat off the bone. And we let a bunch of things and made the adjustments, and within 60 days we had to bring back a portion of that. And I think we're just trying to be wise, especially since -- listen; take the numbers that we talked about in growth and apply them to a \$1 billion business. It's a lot of revenue, a lot of things that have to be built. And so we want to make sure that we can hit. And again, all of you guys and all the folks on the phone have asked the same question is, can you do these things and still sustain the growth? And the answer is we can, but we have to do it with wisdom, and that's what we want to make sure to do. But I think maybe the more important issue is to understand the commitment of really looking at everything. I can be strong willed and strong minded, and other people here want to bring forth ideas. I think we've been receptive to them. Some things we sit down, and we've been able to convince Raul, well wait a second, you didn't understand this part of it. But I think it's a process here and people are engaged in it. That's a long dialogue for that, but that's in fact what we're doing every day. Started at 6:00 this morning in a Ma and Pop cafe down the street.

Operator

Our next question comes from the line of Jason Mills with Canaccord.

Jason Richard Mills *Canaccord Genuity Corp., Research Division - MD of Research & Analyst*

I don't want to talk about the sales growth. What was most disconcerting to me is the awesome deleveraging in the operating line. And the other thing that we've been asking about for several quarters, I'm gratified to hear you mention it, but has been less than optimal is the cash flow. So to me, the stock's going to be down 30%, 25%, whatever it's going to be down tomorrow. For folks I think to either maintain positions or even think about catching what I think is fair to say a falling knife in terms of the stock right now, and I'm just putting this to brass tacks, they're going to have to get comfortable I think less with the sales growth than with your ability to level out earnings and improve cash flows. So I'm most interested in why -- how we got here in terms of the deleveraging of the business. And I understand gross margins being where they are hurts, but the deleveraging of the business relative to the expectations that were in the guidance and folks' models, including my own, is fairly awesome. And so I'm wondering if in fact \$15 million of costs coming out of the business is enough to be able to grow operating margins going forward.

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

It's a good question. And again, we don't think -- the reason we went on -- when we talked about additional things that we need to do, we will do the things that need to be done. We didn't want to say 2% and we were done, and we said up to 5%. We need to do those things. But I think it's also both in terms of CapEx, which we've said we were going to drop by at least \$20 million from this year's level, and the various things that we think that are helping to generate both the revenue growth. It starts at revenues. It starts at these other areas that help to generate that. And I think the ability and the different look that we have now based on all of the leverage points in the income statement, that's another important part. As an example, if we were to take, and I'm just going to use round numbers just to demonstrate. So please, these are -- let's just say you went from SG&A expense of 35%. So they're higher than that right now, and you went down 200 basis points. That's a substantial amount of cost reduction on various types of programs and this kind of thing that we believe is also attainable. And instead of having R&D be as a percentage of sales and just have a number, it's going to have to maintain its growth or its department and get projects at a number that would be less than what they've had in terms of that increase. So they'll essentially have to operate at 2019 levels going forward. Now that means we'll have to be more selective in our R&D projects. Instead of having 50 projects in the pipeline, we will select those. And what we've been doing is looking at those things as to which ones fit tactically and strategically and offer the best opportunities to hit the matrix numbers that we need to hit. So I actually think, Jason, that we'll become more efficient to have more people to work on things that are less, and it will get things through faster to the marketplace. I think we're looking at all of these through improved operating profits and operating margins and increased earnings per share. Raul, you want to add something to that.

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

No, I think it just starts with increasing our earnings. So I think what we're doing right now is making sure that we focus on costs that we can reduce and reducing our footprint and making sure that we generate more earnings. And then obviously just being a lot wiser on the capital expenditure side. Fred mentioned the \$20 million drop next year. With increased earnings, that should help our free cash flow.



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

And let me go a little bit further to that. You've heard us say that we want to do this and be wise about it. We could go out and chop and do this and that. We don't think that's the right thing to do. And this process that we're going through is not one that's going to be done in one quarter. We're going to be doing this as we go through 2020 while making sure that we balance it properly. And that's why people, why don't you do this and why don't you do that? We know this business, we know it well, and then we will make the best decisions. And you will see sequential improvement. Again, I don't want to get into 2020, but we've developed a plan. It's consolidation. It's better efficiencies in the business. It's taking away and doing the things that we don't need to do, but -- that we need to do; not the things we want to do. We're serious about it. I understand the only thing that counts, as you've told me many, many times, is that we have to go out and execute. Well listen; I know where we've come from. No one's been hurt more than this than I have personally. But we have a plan, we have a commitment, and we'll just have to prove it to everybody. We understand it. We don't expect -- whatever haircut we take tomorrow or whatever happens is I think the medicine. And we will go out and do what we said we're going to do until we've reset expectations, and now it's up to us to prove that we can meet those. And that'll be what we will do. So you just -- unfortunately this takes time, but we are on that path. It's not like -- like I've said many times, it's not that we're thinking about it. We're doing something here every day. But I have to do it at the same time, Jason, so as not to scare people, but to make sure that people are at a high level of attentiveness. You know what I mean. You can go out and people get -- you just have to be wise about how you do these things. And we've been through this stuff before and we will be through it again. And we'll look for better days to talk about in the future.

Jason Richard Mills *Canaccord Genuity Corp., Research Division - MD of Research & Analyst*

Thanks for all that color, Fred. I appreciate it. I know it's difficult. Difficult afternoon, difficult call here for you. Not the one that you'd like to do. Just a few follow-ups. I'll get back in queue. So I wanted to go back to cash flow. I wanted to go back to conversion of -- if we're going to do let's say a mid-20s let just say \$1.40 at the low point in pro forma earnings, and we sort of use that as a proxy for operating cash flow. Operating cash flow this year is not going to be anywhere near that. How do you close that gap? It's got to be more than CapEx reduction, I think. How do you close that gap, and do you have confidence that you can close that gap next year? So if next year let's just say a 5% growth in non-GAAP earnings, and you'll get whatever, \$1.60 or something next year, just to put words in your mouth for a second, and \$120 million of operating, sort of pro forma operating income, will we see higher conversion? Will we see cash flow from operations at least, let alone free cash flow, which is just going to reflect capital expenditure reduction. Will we see cash flow from operation conversion be better next year? Can you commit to that?

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

Yes, I can, but Raul wants to discuss it. Go ahead, Raul.

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

I think, look; we're looking at all aspects. Again, I'll just reference that first of all, it comes back to making sure that we're more profitable and that we're converting, flowing that -- more profitability to the bottom line and through free cash flow. We're looking at a number of measures on our working capital. We just implemented a new inventory policy that is going to go live I think January 1st. That'll take some time. We hope to get some costs out of inventory, get our turns up there. That's the biggest nut to crack. Receivables, unfortunately, you've heard me say this. We're growing internationally. So, as long as we can maintain the current DSOs, I think we'll be happy. The reality is when you do business OUS, it takes longer for them to pay, and so we have to deal with that. And we're also looking at payables, squeeze whatever we can there. And again, I think making sure that if we reduce our footprint, there's less CapEx at other sites that we have to spend money on. And then also just we're building a building this year. We're not going to be building a building next year. So that should flow through to free cash flow.

Jason Richard Mills *Canaccord Genuity Corp., Research Division - MD of Research & Analyst*

Okay. Okay, last question and I'll get back in queue. As it relates to these acquisitions, Fred, and you mentioned the analogy of Superman and you found out you were a human. Did you get enamored with these acquisitions in keeping these sales forces, which in many of these cases, Cianna included, DFINE going back a few years, were specialized sales forces and were different than the sales force you employed on an organic basis. And now you're finding out that it's very, very difficult, if not impossible, to maintain all these disparate sales forces which have various levels of -- need various levels of expertise from a technical selling standpoint. And what really the question is, how do the trials and tribulations you're now experiencing, in part vis-a-vis these acquisitions and needing to streamline them and the sales forces specific to them, how does it inform how you'll go about M&A in the future? And I understand you don't have



any plans to do M&A, but I know you, Fred, you're going to be looking for good deals. How will those deals be consummated differently? Thank you for taking the questions.

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

It's a really good question. Let's start with Vascular Insights. Essentially that was all through dealers, and what we've done is converted that over to our direct sales force, and then outside the U.S. we've maintained some of those dealers. So that one was relatively easy. What was painful was that that pipeline got filled up. That's another story for another day and a different audience, but that didn't play out the way that our others have played out in terms of revenue. But we think we have that on track now. So let me go to Cianna. I think on Cianna, we're okay with the folks that we have there. But listen; you're right. There is complexity in all of these things, and we've learned as we've gone along. If we go back to DFINE, I don't know that we have any DFINE sales people left with us at all out of that original group. I think they're all gone. And I think that that was -- looking back now at things, and some of you talked to me about this, that was probably not the best of acquisitions. So we I think have realigned. We have our peripheral intervention, our cardiac intervention. We have our endoscopy business. We have our OEM business. So I think we are aligned at this point to the point where we can be effective in selling, that we can be effective in hitting our numbers and our growth, we have the products, but listen, it's a fair statement to say that we didn't execute as well. We did fine on the ops side. I have to say, if there was any positive stuff on all of this, on all of these things operationally we did quite well. It was on the executing that over on the sales and marketing side. And you're correct; they are different disciplines, different technologies. And I think the learning point is the ones that we've been the most successful on are things that are in a specific bucket where we don't have all the manufacturing or we can bring -- I'll give you an example of the HeRO. That was something we did I think quite well in terms of the transfer. We go back and look at our Snare business, we go back and look at those sorts of things, we did those fine. Maybe we just got a little big for our boots and we did not understand some things. Clearly, they didn't perform the way we wanted to. Now, we haven't given up on all these things, but it's taken a lot more time and we've had to learn some painful lessons. So that's the best way I can answer. Your assessment is reasonably correct.

Operator

Our next question comes from the line of Bob Hopkins with Bank of America.

Robert Adam Hopkins BofA Merrill Lynch, Research Division - MD of Equity Research

Thanks, and good afternoon. Can you hear me okay?

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

We can, sir. Thank you.

Robert Adam Hopkins BofA Merrill Lynch, Research Division - MD of Equity Research

So I just have one question, and it relates to some of the questions that have been asked. Fred, how much of this over the last 6 months do you think is a series of things that didn't quite break your way and now you're having to adjust versus more structural problems that require kind of a rethinking of the strategy and the way the business is run on a more of a structural basis?

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

I think it's pieces of both of them. So let's go to the things that didn't break our way. I think we've discussed those almost ad nauseum. But we talked about it in terms of perfect storm. We have the international business, Brexit. You've got things going on in China. You've got tariffs. You have all of these things that were all not to our benefit. So that's part of it. I think on the structural side of it, I think that whether it be moving things to Mexico, whether I think it's maybe a philosophical deal that we wanted to maintain the R&D capability. So as an example, people have always said, how come you guys can grow from a core point of view more than others? And part of that answer was while that we had -- we have an R&D, a small facility in Texas. We have R&D going on in Ireland. We have R&D going on in France. We have R&D going on in Melbourne. We have R&D even in Mexico, to some extent, and in Texas. It's just a lot to manage and a lot of, I don't want to say disparate groups, but a lot of conflicts there. So I think what we're looking at now structurally is saying, okay, there's too much expense. I think San Jose was a classic example of that. Good people, but not bringing capabilities that create revenues to help us do the things we've been talking about today. And so we made the decision, we've executed that, and it's over. Now, we have to look at the other ones and say that they may be a little bit more complicated. So I think we are assessing the things that we've done in the past, what works, what doesn't work, and so it was a combination of the 2, Bob.



Robert Adam Hopkins *BofA Merrill Lynch, Research Division - MD of Equity Research*

Great. And I'm just curious, just as one quick follow up. Are you bringing in any sort of outside help to kind of think through the structural issues and maybe some of the structural changes that might be needed to get on a better path, or are you guys tackling this all in-house?

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

No, no, no. I think like for instance, one of the things -- we're on an Oracle system as an example of one issue. How we work with Oracle and how we grow up with Oracle as they were reaching down and we were reaching up and we've been with them long time. But we're looking at the issues in terms of the efficiency of those systems, the actual structurally in terms of -- and that affects inventories, order, information, there's a lot of parts of that, and we've brought in consultants and other people. We brought in consultants on a lot of things to assess this. To including when we're going out and doing the Rhapsody project, we've done our own studies before where there were existing products looking for specific indications. With a Rhapsody, it's an entirely different deal where it's a technology that we've developed. We think it has high opportunities. And when you play in the world of IDEs and PMAs, they're a different animal. And so we've brought people in to assess and advise us on the things that we're doing so that we don't make mistakes and say, well why didn't we do this. So we are bringing people in that can advise us on things that we think need looking at. So we're not trying to say not invented here or we didn't think about it so it's not a good idea. I think we go back to the word of being humble. And again, just without sounding strange, but if you look at all of your lives, my life, and we look at businesses, we always find that there's a moment that comes when you understand your weaknesses, and then you try to improve those, and you find that those weaknesses in fact become strengths. So I think that's where we are.

Operator

Our next question comes from the line of Mike Petusky with Barrington Research.

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

I guess I wanted to ask, a few years ago when you guys sort of were really executing at a high level, took the stock from \$15 to \$60 in a short period of time. In your press releases you'd have the strategic, the long-term strategic plan. You'd talk about the long term-strategic plan. You'd say every decision's run through this long-term strategic lens. And there was just a lot of discipline implied in the language that you guys used in terms of CapEx, in terms of M&A decisions, capital allocation decisions. There was just a lot of just -- it seemed tough minded, a tough-minded approach to how you guys were running the business. And it just feels like a lot of this is just self-inflicted. I think you could have survived the FX and the tariffs had you guys kept the same tough-minded approach that you had had 3 years ago when you were executing. And I guess I'm just wondering when you go back and you look at 2020, do you say, you know what, we took the stock up 4 times when we sort of approached the business this way. Maybe it's time to revisit a longer term strategic plan.

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

Mike, without any intent to offend, I think that's what we've been talking about for the last hour is how we're looking --

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

You've said the words long-term strategic plan?

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

Mike, we are looking at tactical and strategic issues that helped us to make sure that we can be predictable, we can be believed and we can accomplish the things that need to be done in the business. I think we have been engaged. As an example, to go to that question specifically, we meet with the finance team every day. Now someone can say, oh, why are you wasting that time? I don't think it's wasted time at all. We have the finance team come in, we've been going through the numbers, we're looking at the strategies, we're looking --. And I can tell you in a long, long time in this business, I've never spent an hour or 2 every day with the FP&A group, the finance group, looking at the things and looking at a strategic plan and the tactics that are necessary to do that. We've spent time, but we are doing that every day to look at the things and the effect that they have and being wise. And I have to also say, with no offense to my accounting team, they're not sales and marketing guys. They don't always understand things, but they do have a certain view of things that we could improve. And I think we've come into this negotiated thing of saying, okay, well did you know this? No. Well, how about if we modify it to this? We're spending a lot of time doing this. And so I would say that, listen; if your assessment is we lost sight in this and that, I'll accept

that. But I want you to know that both tactically and strategically, we are looking at our facilities, our locations, things like automation, things like the product mix. One of the things we're taking a very hard look at is each of the R&D projects has to reach a threshold in order for us to move the dial. So if we were coming up and you're making acquisitions, one of the things that I think that we missed is it was kind of the R&D projects were taking a back seat to the acquisitions. And I think what we have to look at now is, and what we are looking at now, does it meet the threshold and where does this fit? What projects go out that'll allow us to meet those strategic goals that we may not have spent the time on in the last 2 to 3 years? So instead of, as I mentioned previously, having 30, 40, 50 projects, maybe there are 10, but they have a high impact on the business. Now, it also has high risk. And so we have to measure the risk of 10. One of the strengths of our business is that we have all these little products. It's hard to assess all those things. One of the weakness of the business is we have all these little products. And so I think as we're going through this transition, we're looking at the products that'll have an impact, the risk associated with them, and make sure the focus is on those instead of doing business as usual. I think that's tactical, and I think it fits into our strategic plan. Raul?

Raul Parra Merit Medical Systems, Inc. - CFO & Treasurer

Just real quick. I think we like long-term plans. We just need to make sure that we -- we just want to make sure we take the time, finish out 2019 and see where we're at, and then we can talk about a long-term plan.

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

But we're not just talking about the quarter. We're talking about -- we're not giving you the 2020 or 2021 plan, but from a business point of view, we're looking at all those things as well.

Raul Parra Merit Medical Systems, Inc. - CFO & Treasurer

We're just trying to formulate that long-term plan.

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

I'm sorry. What I was really just trying to get at was there was a lot of focus on a 3-year plan every quarter where you guys would talk about it a lot and sort of reemphasize, hey, this is what we're trying to do with gross margins, this is what we're trying to do with earnings, et cetera, and I feel like you guys got away from that. And I'm just wondering -- one of the I think things that was great about the previous longer term strategic plan was that it was public and it was out there. It wasn't, hey, we're doing this and we're doing this and we're doing this, but there's no numbers attached to it. And I guess that's what I'm getting at is is there an idea that maybe that's a better approach for you guys, that it maybe just enforces a discipline upon you guys in terms of capital allocation and M&A.

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

We sat down 5 years ago and sat down and I brought forward to the staff the need to establish credibility, have a plan that we could publish and that we could stand behind, and we put that plan into effect. Now I will come to issue with you. I don't think it's an issue of whether we survived FX. But I will tell you that things for instance in China are not the same as they were 5 years ago. We've got them wanting to buy local and they have initiatives. You have the currency itself. You have the government looking for lower prices. So it is a different world today, and the best companies and the companies that survive the long haul do adapt to the conditions. Brexit may not seem -- I had one analyst say to me not long ago, well listen, gee, you're the only guys talking about Brexit. Well, yes, we were the only -- I don't know who was talking. I wasn't listening to other people. I was talking about when I get a call from the NHS who says, please come up and share with us your strategy for making sure that we can get medical devices into Great Britain, that got my attention. And with all the noise going on and the battles, we thought we have to do something so we can answer the question and we did. So that was the right thing to do, and it's going to serve Merit very I think positively going forward. So listen; I accept your criticism. I think you have very good points. You're not right on all of your points, however. And we'll be happy to talk about those in our call following this meeting. But I do appreciate you bringing the topic forward so that we can talk about it to everybody.

Operator

Our next question comes from the line of Steven Lichtman with Oppenheimer.



Steven Michael Lichtman *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

Just on fluid management, I know you mentioned obviously not building anything in here in the near term. But can you remind us of how big you think that opportunity is? Any type of scaling you can provide would be helpful.

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

Yes. Again, these are the numbers that have been shared to me of what the opportunity. Let's go to the Premier deal. Premier is the largest GPO in the country. We are the exclusive for fluid administration in all of their hospitals. They have about an 85% compliance rate. And my understanding is it represented \$20 million to \$30 million worth of annual business. But again, that's what that level is now, and then what we have to do is work into that, make the conversions, do the training, and there'll be inventories and that sort of thing. It's not just quite as easy as taking an off the shelf because a good portion of these products are custom. So that's the first part. On the other part of that, there was a situation where Angio was the preferred provider for a large national distribution and device company. And that business was sold by Angio to Medline. And so this other company, of course, that has products with their main competitor. And so they came to us and said, we would like to be able to have you guys be our new preferred provider. You have product, and in fact, you have a broader product offering than the people we've been using. And we have worked through, we have contracts. They are in place, they are signed. They were signed late September, early October, so it's relatively new. And then we have to go through that same process. That's worth somewhere between \$10 million and \$20 million. So again, it all depends on what percentage of this do we get, how long does it take, and that's why going to 2020, until we get a better feel of what it looks like through the end of this quarter and early next, we're hesitant to go throw a number out there and somehow we miss it and we don't meet that number. So we need to understand more about it, but I think the good news, Steve, is that we -- this is something we do every day. This is something we build every day, so there's no capital required, there's no new facilities required. We have capacity for these products. But we just have to let it play out and then you'll see that reflected, and we will share what we see in that increase and whether it's in fact what we've been told it is. But we haven't built inventory. We're not out there doing things in anticipation. But we do expect that it's going to be meaningful, I will say that. I haven't lost my enthusiasm for it. It's just about the implementation.

Steven Michael Lichtman *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

Got it. And then maybe a couple for Raul. You talked today about some new facility consolidation. But can you talk about the Melbourne facility move to Mexico, which I believe has been underway? Where are you in that process, and how much could that save on COGS, next year?

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

Yes. So it's well on its way. We think by Q2 we should be mostly out of there. There's one product line we're looking at right now, but for the most part it's on track. We've started our inventory builds for transition. There's some lines that have already moved. When we look at the savings, it's approximately \$4 million. You won't pick up the full benefit next year, though, because you're -- by the time you get it all done, it's going to be halfway through the year. But we do expect that benefit to pick up in 2021. So I think it's well underway, it's on track, and yes, nothing more to say there.

Steven Michael Lichtman *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

Okay. And then just lastly, the \$15 million in annualized cost reduction to date here that you mentioned, how much of that is in OpEx and how much of it is in COGS?

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

About 75%.

Steven Michael Lichtman *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

OpEx. It's 75% in OpEx?

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

Yes, 75% in SG&A and R&D.



Steven Michael Lichtman *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

Okay, got it. All right.

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

And by the way, Steve. Steve, just one last thing onto that. That isn't the total number of cost savings. There's other things that we have done that are in addition to that. So that's the headcount reductions, and there are other programs and things that we've initiated that'll add additional dollars. You want to add any light to that one, or do you want to just leave that one closed?

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

No, I just want to close it. Again, I think when we talk about the \$15 million, it's the 2% plus the San Jose closure.

Steven Michael Lichtman *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

Got it. All right.

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

And those things are done -- okay, great. Okay. Well listen, ladies and gentlemen, it's the longest call we've ever had and appropriately so. We're going to spend about 10 minutes reviewing with our staff comments and taking questions here internally, and then Raul and I will be here to take additional questions and clarifications following that. So, thank you very much for your attendance. We're serious about what we're doing. I suppose -- I don't know, I'm not going to apologize. I don't like it any more than you do. Watch what we do. I think we've taken the steps that we need to, there are more steps to take, and we'll look forward to reporting the results and our strategies and tactics going forward. Have a very good evening and good night.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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