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# Endologix, Inc. (ELGX)

Q4 2017 Earnings Call

## CORPORATE PARTICIPANTS

John D. McDermott  
*Chief Executive Officer & Director, Endologix, Inc.*

Daniel T. Lemaitre  
*Chairman, Endologix, Inc.*

Vaseem Mahboob  
*Chief Financial Officer, Endologix, Inc.*

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Greetings and welcome to the Endologix Fourth Quarter and Fiscal Year 2017 Earnings Conference Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference call is being recorded. This conference call is also being broadcast live over the Internet at the Investors section of the company's website at [www.endologix.com](http://www.endologix.com), and a webcast replay of the call will be available at the same site approximately one hour after the end of the call.

Before we begin, I would like to caution listeners that comments made by management during this conference call will include forward-looking statements within the meaning of federal securities law. These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the Company's actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements.

For a discussion of risk factors, I encourage you to review the Endologix Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 1, 2017, and subsequent reports filed by the company with the Securities and Exchange Commission.

Furthermore, the content of this conference call contains time-sensitive information that is accurate only as of the date of the live broadcast, February 21, 2018. Endologix undertakes no obligation to revise or update any statement to reflect events or circumstances after the date of this call.

With that said, I would like to turn the call over to John McDermott, Endologix' Chief Executive Officer. Mr. McDermott?

## John D. McDermott

*Chief Executive Officer & Director, Endologix, Inc.*

Thank you, operator. And good afternoon, everyone.

Before we begin our call, I'd like to comment on the press release that was issued today after our earnings announcement. After nearly 10 years at Endologix, today, I'm announcing that I'll be stepping down as CEO. The past couple of years have been difficult for the Company, employees and investors, so it's time for a leadership change. I'm confident that Endologix has a bright future and is well-positioned for long-term growth. Our vision is clear, our value proposition is compelling, and we have the best new product pipeline in the industry. I remain deeply committed to our employees, physicians and patients, and have agreed to continue in my current role until the Board of Directors hires a new CEO.

Now, I'd like to provide a brief overview of our fourth quarter results and key business updates. I'll then turn the call over to our Chief Financial Officer, Vaseem Mahboob, who will review our fourth quarter and fiscal year 2017 financial results, and our 2018 financial guidance. After that, our Chairman of the Board, Dan Lemaitre, will make a few closing remarks, and then we'll open up the call for questions.

Starting with our fourth quarter, global revenue was \$44 million, finishing at the low end of the guidance range. Full year 2017 revenue was \$181.2 million, 6.1% lower than 2016. The drop in revenue in 2017 is primarily due to an AFX recall and manufacturing hold at the end of 2016, sales force turnover in the U.S., and the transition to the updated IFU with Nellix in Europe. Collectively, these issues had a significant impact on the business in 2017. However, we have made tremendous progress strengthening and stabilizing the Company. In particular, we're pleased with our clinical results and the continued growth of the Ovation product line, which saw revenue growth of over 40% in 2017.

Turning now to our new product pipeline. We're pleased to have completed patient enrollment in the ELEVATE IDE clinical study. This 75-patient study is to evaluate the safety and effectiveness of the Alto Abdominal Stent Graft System for the repair of infrarenal abdominal aortic aneurysms. We plan to file regulatory submissions in the third quarter of 2018 and anticipate potential approval of the Alto device in both the U.S. and European markets in 2019. This is an exciting new product that has received very positive feedback from clinical investigators, and we look forward to bringing it to the market as soon as possible.

Next is Nellix. We received the IDE approval of the EVAS2 confirmatory clinical study in the fourth quarter of last year, and expect to enroll our first patient in the first quarter of this year. The study is approved to enroll up to 90 patients with one year follow-up data required for the pre-market approval application. We're excited to begin enrollment this quarter, and look forward to providing the unique benefits of complete aneurism sealing to patients in the United States.

Turning now to ChEVAS. We are planning our initial submission to FDA in the first quarter of this year, and hope to be in a position to enroll our first IDE patient in the third quarter of 2018. We are also continuing to pursue a CE mark for European approval, and we'll provide an update on that regulatory process later this summer. We also have several upcoming clinical data presentations over the next few months, including the [indiscernible] (00:05:11) study with the Ovation platform, an update on the LEOPARD prospective randomized clinical trial, a study comparing the mortality rates between EVAS with Nellix and EVAR, and the LUCY one year results comparing clinical outcomes between men and women. We believe these clinical results will provide important evidence to support the adoption of our devices in 2018 and beyond.

One final update. I'd like to welcome Greg Morrow as our Chief Marketing Officer. Greg joined us at the end of January to lead the Company's global marketing team. Greg is a proven marketing executive with a strong track record of growing medical device businesses in highly competitive and challenging environments and achieving breakthrough results. His experience will be invaluable in both strengthening our brand value proposition and maximizing the impact of our innovative new product pipeline.

With that, I'll now turn the call over to Vaseem to review the Company's financial results and 2018 guidance. Vaseem?

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## Vaseem Mahboob

*Chief Financial Officer, Endologix, Inc.*

Thank you, John, and good afternoon, everyone. First of all, I'd like to thank John for his 10 years of leadership at Endologix, and to express how much I appreciate the time I've spent working with him. He's one of the most passionate, knowledgeable and dedicated executives I've ever known. I'm honored to be on the same team as John, and I wish him well in his future endeavors.

Now, let me review our financial results. As John mentioned earlier, our total revenue for the fourth quarter of 2017 was \$44 million, a 7.3% decrease from \$47.5 million in the fourth quarter of 2016. Our total revenue for fiscal year 2017 was \$181.2 million, a 6.1% decrease from \$192.9 million in the prior year period.

U.S. revenue for the fourth quarter of 2017 decreased 12.2% to \$29.5 million, compared to \$33.7 million a year ago. For fiscal year 2017, U.S. revenue decreased 9.5% to \$123.2 million, compared to \$136.1 million a year ago.

In both the quarter and during the year, continued strength in Ovation was more than offset by declines in our AFX2 business, which was impacted by the slower than expected sales recapture.

Fourth quarter international revenue increased 4.8% on a reported basis to \$14.5 million, compared to \$13.8 million a year ago. Most of that growth was driven by AFX, which faced a easier comp due to the disruption in the fourth quarter last year when our CE Mark in Europe was temporarily suspended. Nellix was up sequentially, but down year-over-year due to the narrowed IFU.

On a constant currency basis, fourth quarter 2017 international revenue increased 0.8%. Fiscal year 2017 international revenue increased 2% on a reported basis to \$58 million, compared to \$56.8 million a year ago, as strong growth in AFX and Ovation was somewhat offset by declines in Nellix in both Europe and [indiscernible] (00:08:23). On a constant currency basis, fiscal year 2017 international revenue increased 1.2%.

Historically, we have not provided any product level revenue detail for competitive reasons. However, we realized the market challenges associated with not having that information. So, at this time, we will provide global revenue for our three product lines. For 2017, our global AFX business generated revenues of \$113.8 million, Ovation reported revenues of \$57.9 million, and revenues from Nellix totaled \$9.4 million.

Our fourth quarter gross margin increased 9.2 points to 71.3%, compared to 62.1% in the fourth quarter of 2016. On an operational basis, our year-over-year margins were up slightly to 68.9% from 68.8%. These numbers reflect a \$3.2 million inventory charge in the fourth quarter of 2016, due to the AFX quality issues, and a \$1.1 million favorable impact of capitalized variances due to our AFX inventory build in the second half of 2017.

For fiscal year 2017, our gross margin increased 2.8 points to 67%, compared to 64.2% in the prior year period. While we are pleased with our 2017 margin performance in light of the manufacturing issues, we expect to see

some headwinds in 2018 due to anticipated lower volumes in Irvine and our initiatives to reduce global inventories to improve our cash performance. We have continued to make excellent progress with our operating expenses, which decreased substantially to \$40.3 million in the fourth quarter of 2017, compared to \$51.7 million in the fourth quarter of 2016. Excluding restructuring and merger-related costs, operating expenses in the fourth quarter 2017 were \$10.3 million lower than in the prior year period, representing a decline of 21%, which was driven by selective cost controls and synergistic improvements.

For fiscal year 2017, our total operating expenses totaled \$163.1 million, compared to \$218.9 million for the prior year period. As we have stated in the past, we don't expect to report any significant reductions in our operating expenses beyond current levels, and believe operating expenses in the near future will be generally in line with 2017 levels. We believe we have right-sized the business and now we will turn our focus to reinvesting as we return to top-line growth.

Looking more closely at our fourth quarter operating expenses, marketing and sales expenses were down 15.3%, G&A down 8.8%, research and development expenses decreased 47.6%, and our clinical and regulatory expenses decreased 30.4% year-over-year. While these are substantial reductions, we are confident that we continue to make investments that align with our strategy to drive long-term growth in the business.

Net loss for the fourth quarter of 2017 was \$14.5 million, or \$0.17 per share, compared to a net loss of \$24.9 million, or \$0.30 per share, for the fourth quarter of 2016. Adjusted net loss totaled \$7 million, compared to an adjusted net loss of \$18.3 million for the fourth quarter of 2016. We reported a negative adjusted EBITDA of \$2.7 million for the fourth quarter of 2017, compared to a negative adjusted EBITDA of \$13.2 million for the fourth quarter of 2016.

For the year ended December 31, 2017, we reported a net loss of \$66.4 million, or \$0.80 per share, compared to a net loss of \$154.7 million, or \$1.91 per share, for the year ended December 31, 2016. Adjusted net loss totaled \$39.5 million, compared to an adjusted net loss of \$63 million a year ago. We reported a negative adjusted EBITDA of \$19.2 million for the year ended December 31, 2017, compared to a negative adjusted EBITDA of \$41.4 million for the year ended December 31, 2016.

Moving to the balance sheet, our total cash, cash equivalents, restricted cash and marketable securities were \$60.6 million as of December 31, 2016 (sic) [2017] (00:12:53), compared to \$49.1 million as of December 31, 2016. The cash balance includes \$18.3 million of outstanding 2018 notes. Our cash burn for the quarter was approximately \$6.9 million. On a related note, we continued to make progress on replacement of our prior Deerfield credit facility, and we'll give you the details once it's finalized. We are optimistic that we can finalize the deal where there will be no material change to the net capacity of the business relative to the previous facility with Deerfield.

Now, turning to guidance. We anticipate 2018 revenues in the range of \$170 million to \$180 million, representing a decrease of 1% to 6% compared to 2017. This guidance reflects changes to our go-to-market strategy in some European markets, most notably a full exit from France and revised minimums for our distributors in Europe and Latin America. The revision in minimums is to reflect the [indiscernible] (00:13:52) and to provide relief to distributors for the AFX disruption in 2017. The impact of these two changes is approximately \$8 million.

On an apples-to-apples basis, we expect modest growth in our base business in 2018, and we will update our revenue guidance range as necessary as we get into the second half of the year. Staying on revenue guidance for the first quarter of 2018, we anticipate revenue in the range of \$40.5 million to \$42.5 million. We anticipate our full year 2018 GAAP loss per share in the range of \$0.89 to \$0.95 per share.

And now, I'd like to turn the call over to Dan. Dan?

Daniel T. Lemaitre

*Chairman, Endologix, Inc.*

Thanks, Vaseem.

On behalf of the Board and the entire Endologix team, I would like to express to John how truly grateful we are for his remarkable passion and dedication to the Company, as well as to doctors and their patients around the globe. His leadership has been critical in positioning Endologix as an innovation leader in the treatment of AAA disease. And he has been instrumental in bringing a very talented team that will take the Company to another level of success.

The Board has commenced a search for a new CEO, and we greatly appreciate John's commitment to ensuring an effective leadership transition. We appreciate his continued involvement and support of Endologix, and, of course, we wish him well in his future endeavors.

With that, we will now open the call for questions. Operator?

## QUESTION AND ANSWER SECTION

**Operator:** At this time, we will be conducting a question-and-answer session. [Operator Instructions] Our first question comes from Joanne Wuensch of BMO Capital Markets. Please proceed with your question.

Matthew Henriksson

*Analyst, BMO Capital Markets (United States)*

Q

Yes. Hi. This is Matt Henriksson, in for Joanne. John, first off, I just want to say it's been a pleasure to have met you over the past few years, and I wish you the best of luck in your next endeavors.

John D. McDermott

*Chief Executive Officer & Director, Endologix, Inc.*

A

Thank you.

Matthew Henriksson

*Analyst, BMO Capital Markets (United States)*

Q

Yes. And then focusing on the next CEO, Dan, this may be a question more for you, but how do you guys see the timing of the transition and what qualities are you looking for in a replacement. And then, just also – is it – are you guys going to be doing an internal or an external search?

Daniel T. Lemaitre

*Chairman, Endologix, Inc.*

A

Okay. A few questions in that. First off, from just a process perspective, the Board has hired Spencer Stuart, and we will be working with them and have been working with them to get a sense of the talent landscape. The timing of that process, obviously, is something that we can't pin down exactly other than to tell you we plan on being efficient and timely. The Board has created a search committee that, I think, will be able to move relatively quickly

here. The good news is, as you know, we have the luxury of having John staying on during our transition period here. And so, we fully expect to be able to do this in an orderly fashion. And I know John, in particular, is bent on making this one of the best transitions that people have been able to see. So, with that process in place, with John helping us during this transition, we're confident we're going to be able to find a top candidate for this slot.

In terms of the actual capabilities and profiles that – I'm sure you got the same laundry list of things you'd like to see that the Board has honed in on, but at the end of the day, we're going to be looking for folks with the right experience and strategic vision and leadership capabilities that we think will really allow the Company to move forward and capitalize on all the hard work that John and his team have done over the last few years.

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**Matthew Henriksson**

*Analyst, BMO Capital Markets (United States)*

Q

Thanks. That's very helpful. And then, Vaseem, one on the 2018 guidance. You mentioned some impacts from the full exit from the France, and some of the distributors in Latin America. There wasn't any commentary on potentially the U.S. sales guidance, firstly given how it's still little sluggish towards the end of 2017. Are we going to see some of that roll over into 2019 as well?

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**Vaseem Mahboob**

*Chief Financial Officer, Endologix, Inc.*

A

Yeah. I think the way to think about it is the \$170 million to \$180 million guidance actually is built off of that variable, is kind of the continued softness of AFX [indiscernible] (00:19:25) experience to kind of end up in the \$170 million range, but if we do see that business could stabilize relatively sooner than later, we're probably looking at the high end of the range. So, that is the single biggest variation to our guidance range for 2018.

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**Matthew Henriksson**

*Analyst, BMO Capital Markets (United States)*

Q

Great. Thank you very much.

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**Operator:** Our next question comes from Mathew Blackman of Stifel. Please proceed with your question.

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**Mathew Blackman**

*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

All right. Good afternoon, everyone. Can you hear me okay?

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**Vaseem Mahboob**

*Chief Financial Officer, Endologix, Inc.*

A

Hey, Matt. Yeah, we can right now.

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**John D. McDermott**

*Chief Executive Officer & Director, Endologix, Inc.*

A

Yeah. We can hear you.

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**Mathew Blackman**

*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

To start, John, I've also enjoyed working with you the last several years and want to wish you the best of luck in your future endeavors as well.

John D. McDermott

*Chief Executive Officer & Director, Endologix, Inc.*

A

Thank you.

Mathew Blackman

*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

You're welcome. So, the first question is, maybe start on guidance for 2018. Maybe the sort of simplest way to think about it, and maybe even see if you can tackle this, is if we think about sort of true underlying growth, is it something more like if I just add back that \$8 million, is it something more in the down 2% to up 4% range? I'm just trying to get a sense of, ex all of the noise with your restructuring in Europe and planned exits, what the real sort of base business is – what's implied in there for the real base business.

Vaseem Mahboob

*Chief Financial Officer, Endologix, Inc.*

A

Yeah. Matt, I think that's what I said in my prepared remarks here, the impact that you see, the \$8 million, is really the one-time hit that we have taken in France. It was about \$2 million to \$3 million, and then the rest of it is all of these revised minimums to distributors to make them hold for the disruption that they saw in 2017, which I think is a one-time event. And going forward, all of their contracts have been then reset to growth profiles that we expect them to have prior to the disruption. So, I think you're thinking about the right way is to just add that \$8 million to the \$170 million on the low end, then on the \$180 million on the high end to kind of give you a sense on what the normalized growth rate would be. And that's why I said, it's modest growth. It's not high growth. But it's modest growth when you look at the base business year-over-year.

Mathew Blackman

*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

Okay. That's helpful. And then, on guidance as well, just want to make sure I heard your gross margin commentary correctly. Should we think about 2018 – you said, I think said, it might go down in 2018. I just want to think about sort of the right base to think of it, going down off, should we be looking at 2017 as sort of the base and it's a little bit lower margin? Also help me sort of understand that commentary.

Vaseem Mahboob

*Chief Financial Officer, Endologix, Inc.*

A

Yeah. So, we've spent a good bit of time looking at that. So, there's really – so, when you look at how big the range is, the \$170 million to \$180 million, and that range, like I said, is predicated on the single biggest driver being the U.S. business. And as you know, there's a pretty significant margin delta between our U.S. business and our OUS business. So, as that – if that business is tracking to the \$170 million range, obviously we'll see a lot more headwind on margin and rates versus if it's tracking to the \$180 million. The second thing that we're also trying to do is drive some cash performance, and you've heard this in the past that we hired John Onopchenko as our Chief Operating Officer. He is actually looking at operations slightly differently, so we'll probably see some productivity. But at the same time, we're actually trying to make inventories down year-over-year.

So, all of that packaged together, we think there's going to be a pressure on hours here in Irvine, which is going to be creating some headwinds from an overhead absorption perspective. So, that's how I wanted you to think about it. So, again, it's all tied to the range, but as we get closer towards the end of the year, we'll have better visibility that we'll be passing along to you guys on the scheduled calls.



Mathew Blackman

*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

Okay. And then, I'll just lump two fourth quarter questions together. On AFX in the past, sort of three quarters that you've commented, or at least last two quarters, you've commented that the – from a dollar basis standpoint, that the AFX business has been stable. Is that narrative the same here in the fourth quarter? And then, the second question. International is a little bit ahead, I think, of your expectations. Just wanted to get a sense of, was that Europe, was that sort of the Nellix sequentially, or is that more in your rest of the world business?

Vaseem Mahboob

*Chief Financial Officer, Endologix, Inc.*

A

That's a lot of questions, Matt. So, let me kind of break it into two pieces. The first one, if you remember what we had said when we put out the guidance of the \$44 million to \$47 million range, the \$44 million, we were very clear, was predicated on the fact that we would not see any significant improvement in the AFX update. And that really didn't happen, that's why we ended up at the \$44 million. So, the way you guys got to be thinking about that, that business has not stabilized, that that business is stabilizing, so more to come on that.

Now, on the OUS side, there was a little bit of a help that we got on FX, but it wasn't anything unusual than we were expecting that business to be, so it came in as expected.

Mathew Blackman

*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

Okay. Thanks so much.

Vaseem Mahboob

*Chief Financial Officer, Endologix, Inc.*

A

Yeah. Thanks, Matt.

**Operator:** Our next question comes from Chris Cooley of Stephens. Please proceed with your question.

Chris Cooley

*Analyst, Stephens, Inc.*

Q

Good afternoon. And John, let me just continue to echo the sentiments. It's been a pleasure to work with you, and I wish you and your family all the best. And it's great to see what you've done, taken the Company here over the last roughly 10 years. It's a lot of progress, so all the best.

John D. McDermott

*Chief Executive Officer & Director, Endologix, Inc.*

A

Thanks, Chris.

Chris Cooley

*Analyst, Stephens, Inc.*

Q

Just from me, I guess a couple of quick ones here. Vaseem, could you maybe go back? I believe you said that the burn in the 4Q was \$6.9 million, which I think is about 2-ish, 2.5-ish below what you thought about in the past. I just want to kind of triangulate on that number a little bit and make sure that's how we should be thinking about

coming into the New Year, and then maybe some puts and takes against that. And then, I have a follow-up question as pertains to growth in 2018 from Nellix. So, maybe we start with the cash flow?

Vaseem Mahboob

*Chief Financial Officer, Endologix, Inc.*

A

Sure. So, yes, the cash burn was about \$6.9 million, and that's off of some solid cost performance. And I got to tell you, I got to give the team a lot of credit here on what the team has been able to accomplish in 2017. So, if you guys remember, we have brought that guidance down three times through the year. And the last time we kind of put it out there was \$165 million to \$170 million, and we ended up lower than that. So, the \$6.9 million, while it was the actual, Chris, the number that we have said in the past is unchanged where we've said that the burn continues to be in the \$8 million to \$10 million range.

Chris Cooley

*Analyst, Stephens, Inc.*

Q

Right.

Vaseem Mahboob

*Chief Financial Officer, Endologix, Inc.*

A

And we'll continue to kind of see that through next year. And also, recognize that we'll start to, in 2019, reinvest back into the business, and flattish to slightly up year is what I would expect to be in – is the assumption that we have in that loss per share number for 2018. And the other thing, when you'll try and do the financial statements walk, you'll see that the \$6.9 million, we actually had a higher cash balance, the delta between what you see on the balance sheet is that we received \$6 million of cash from [ph] GLL (00:26:49), as part of the thoracic agreement, and you guys can do the math on that. But really \$6.9 million in the cash burn, would expect \$8 million to \$10 million going into 2018 per quarter.

Chris Cooley

*Analyst, Stephens, Inc.*

Q

Okay. Thank you for clarifying that. And then, just when we think about 2018, I appreciate the color on the change in distributors in Europe and also the exodus from France, but when we think about Nellix, should we assume that that business continues to base as we go through 2018 and 2019, is really more of the transition year when we think about a resurgence in growth abroad or would you characterize it as having based but under the revised IFU and the change in minimums with distributors that businesses is trending flattish? I'm just trying to get a little bit more color as we look out to 2018.

Vaseem Mahboob

*Chief Financial Officer, Endologix, Inc.*

A

So, as you saw in my prepared remarks, I gave you guys the Nellix number, which was \$9.4 million. And what's reflected in our guidance is a relatively flat Nellix number year-over-year. And Chris, it's very consistent with what John and I've been saying in the past, which is that we saw a softening of the business. And the \$9.4 million, by the way, was almost down 50% to 60% year-over-year. And, if you remember, the change in the IFU happened in Q4 of 2016, and then it kind of manifested itself in a change in IFU for the distributors in Q1 of 2017, so that's probably one more quarter of negative comps. And then, after that, we should see a relatively stable Nellix business going into Q3 and Q4.

Chris Cooley

*Analyst, Stephens, Inc.*

Okay. Super. Thank you so much.

Q

Vaseem Mahboob

*Chief Financial Officer, Endologix, Inc.*

You're welcome.

A

**Operator:** Our next question comes from Mike Weinstein of JPMorgan. Please proceed with your question.

Q

Hi. So, I just had a question on kind of the clinical trials you guys have planned on. This is actually [ph] Allan (00:28:59), on for Mike also.

John D. McDermott

*Chief Executive Officer & Director, Endologix, Inc.*

Hey, [ph] Allan (00:29:01).

A

Q

When you kind of like get these results out, do you expect to see like any kind of pickup or any kind of benefit to your revenues within the year or do you think it's more kind of a – a more incremental kind of data readout over the course of the year?

John D. McDermott

*Chief Executive Officer & Director, Endologix, Inc.*

Well, it's a good question. We do think that the data readouts are going to be positive for the continued adoption of the products, but have captured that expectation within the guidance. So, you obviously have to stay tuned for the results that get presented over the next few quarters. And we think they'll be positive, but we think it falls within the stated guidance, in fact.

A

Vaseem Mahboob

*Chief Financial Officer, Endologix, Inc.*

And then, [ph] Allan (00:29:48), the Nellix number that factored into our guidance is for the IDE cases that we expect to do for EVAS2 trial is in the \$1 million or so range, so it's not a big number, but that's already factored to John's point in the range.

A

Q

Okay. Thanks. That's really helpful. And then, just kind of a second question, just in terms of kind of once you get like Nellix and kind of AFX stabilized, should we think about them being relatively flat going forward after you stabilize the declines? Do you think we can kind of see a return to growth or should we really only see Ovation as kind of the main growth driver going forward until we can get maybe the Nellix approval later in 2021?

Vaseem Mahboob

*Chief Financial Officer, Endologix, Inc.*

A

No. So, what we have done in the guidance here, guys, is, as we have said at JPMorgan and in some other conferences since then, we have now made a conscious choice to shift the focus primarily in the U.S. from AFX to Ovation. And that's because we think there's a lot of growth opportunity within Ovation, and Ovation had a terrific year in 2017. So, even if it cannibalizes some of the AFX business, I think we are okay with that. And I think that's going to be a conscious tradeoff that we plan to make in the U.S. But outside of that, listen, the real growth for us starts to come in with the launch of Alto in 2019 and then Nellix in 2020 and then ChEVAS in 2021, and that's a pipeline that nobody else has, and we are very optimistic about that.

**Operator:** Our next question comes from Richard Newitter of LEERINK Partners. Please proceed with your question.

Jaime L. Morgan

*Analyst, LEERINK Partners LLC*

Q

Hi, John. Hi, Vaseem. This is Jamie Morgan, on for Richard Newitter.

John D. McDermott

*Chief Executive Officer & Director, Endologix, Inc.*

A

Hey, Jamie.

Jaime L. Morgan

*Analyst, LEERINK Partners LLC*

Q

So, the first question I had was on an Ovation. I think, if I heard you guys correctly, you said it grew about 40% in the fourth quarter. So, just thinking about that coming off of a 30% growth rate, I think, in the third quarter, how should we think about the sustainability of this sort of growth rate? And then, with the introduction of Alto in 2019, is this something that we could think as accelerating off of these sorts of levels or something that is just going to be more and – a more reasonable double-digit growth rate?

Vaseem Mahboob

*Chief Financial Officer, Endologix, Inc.*

A

Yeah. So, Jamie, let me clarify first. The 40-plus percent growth rate that John referenced to was for the full year 2017, not Q4. So, I just want to clarify that. Now, having said that, we are in the \$170 million and the \$180 million, both of those ranges actually have a Ovation growing number, and the question is how much. And obviously, it's too early into the year. And as I was talking to [ph] Allan (00:32:44) at JPMorgan about this conscious choice to move off of AFX to Ovation, I think it's really hard to kind of get a sense on what the cannibalization rate is going to be, but we'll obviously share those details with you as we kind of go through the rest of the year. But what you've got to assume is that in the \$170 million and in the \$180 million, there's a very healthy Ovation growth number, and really the delta from \$180 million to \$170 million is the kind of lack of visibility on AFX and AFX performance primarily in the U.S.

Jaime L. Morgan

*Analyst, LEERINK Partners LLC*

Q

Okay. Great. That's helpful. And then, one other quick one. I think you guys were kind of talking about maybe making some sort of reimbursements back into the business this year. So, if you could call out any sort of things that you're thinking about reinvesting in in the upcoming year that would be helpful.

Vaseem Mahboob

*Chief Financial Officer, Endologix, Inc.*

A

Well, the comment was more about 2019 – 2017. I think you should expect a flattish operating expenses number, and you would start to see that number grow in 2019 and beyond as we start to grow the top-line again. So, until we start to see top-line growth – sustained top-line growth, we'll probably kind of keep the cost controls in place and make sure that we look at it very carefully.

John D. McDermott

*Chief Executive Officer & Director, Endologix, Inc.*

A

Yeah. Jaime, it's John. The only sustaining investments are the EVAS2 IDE clinical trial and then getting started with the ChEVAS study in the second half of the year. So, as Vaseem pointed out, we are continuing to invest in these high-value programs.

Vaseem Mahboob

*Chief Financial Officer, Endologix, Inc.*

A

Yeah. Those are all funded.

A

Yeah.

Jaime L. Morgan

*Analyst, LEERINK Partners LLC*

Q

Okay. Understood. Thanks so much.

John D. McDermott

*Chief Executive Officer & Director, Endologix, Inc.*

A

Thank you.

**Operator:** [Operator Instructions] Our next question comes from Jason Mills of Canaccord Genuity. Please proceed with your question.

David Rescott

*Analyst, Canaccord Genuity, Inc.*

Q

Hey. It's Dave Rescott, on for Jason. Can you hear me all right?

John D. McDermott

*Chief Executive Officer & Director, Endologix, Inc.*

A

Yeah, we can hear you. Hey, Dave.

David Rescott

*Analyst, Canaccord Genuity, Inc.*

Q

Hey. Quick question first on EVAS2. I think in the third quarter you had noted that probably by the end of 2017 you're expecting to see the first patient enrolled. First on that one, I know now it's going to push up in the first

quarter of 2018. Can you maybe talk about how many sites are up and running or what the process has been like getting those sites up and going, and maybe kind of what type of sites you've been going for? And then, as far as on the LEOPARD study, are you looking to kind of have that position coming out this year as far as stabilizing loss and then returning to growth this year or should we start to think about AFX deteriorating continually going forward? Then I have a follow-up as well.

John D. McDermott

*Chief Executive Officer & Director, Endologix, Inc.*

A

Yeah. So, first with EVAS2, our original assumption is that with several of the sites that we're in EVAS1, that we might be able to get them up and running a little faster. But in fact, it takes as long to get through the IRB process, the second time as it did the first time. So, really the shift is more a reflection of that. That said, we are seeing some good activity now and look forward to starting enrollment this quarter.

For LEOPARD, we do plan to provide an interim readout of the LEOPARD preliminary results at the SCVS meeting next month, and then the full one year results near the end of the year, sometime in the fourth quarter. Once we have the full data set out one year, we'll provide another readout at that point in time. I do think that the LEOPARD results will provide support for those clinicians to continue to use AFX and AFX2, and those results are – continue to be very good. Really the reason for the shift, and we get asked this quite a bit, why the focus on Ovation, is simple, we can just simply treat more patients with Ovation but the two products complement each other nicely.

David Rescott

*Analyst, Canaccord Genuity, Inc.*

Q

All right. And then, going back to the third quarter, I think again you mentioned that the impact from hurricanes was \$752 million. Did you see any of that or most of that pull through within the fourth quarter?

John D. McDermott

*Chief Executive Officer & Director, Endologix, Inc.*

A

We looked at the number [indiscernible] (00:37:01). It was a very immaterial number, less than \$250,000 is what we saw in recovery in the fourth quarter.

David Rescott

*Analyst, Canaccord Genuity, Inc.*

Q

Okay. Thanks so much.

John D. McDermott

*Chief Executive Officer & Director, Endologix, Inc.*

A

Yeah. Thank you.

**Operator:** Our next question comes from Chris Pasquale of Guggenheim. Please proceed with your question.

Chris Pasquale

*Analyst, Guggenheim Securities LLC*

Q

Thanks. John, I want to join everyone else in wishing you the best of luck with whatever comes next.

John D. McDermott  
*Chief Executive Officer & Director, Endologix, Inc.*

A

Thank you.

Chris Pasquale  
*Analyst, Guggenheim Securities LLC*

Q

My first question is on the balance sheet. It would seem, if I heard you correctly, you're expecting \$8 million to \$10 million in quarterly cash burn throughout 2018. You got about \$60 million today. As you look out over the next two years, how are you thinking about the path toward breakeven and your incremental cash needs?

Vaseem Mahboob  
*Chief Financial Officer, Endologix, Inc.*

A

So, Chris, really no change to what we've been talking about. We're still holding on to the second half 2019 cash flow breakeven guidance that we put out there. It's predicated on a lot of different assumptions around top-line, on OpEx, our gross margins that I was talking about, and we see line of sight to that. But at the same time as you've heard today on the transition here, obviously that could change on how we think about the business and what the design of the place are going to be in the future. So, stay tuned for that.

Chris Pasquale  
*Analyst, Guggenheim Securities LLC*

Q

Okay. Thanks. And then, John, maybe just give us an update on the state of the sales force at this time. So, how many reps did you exit the year with in the U.S. and Europe, and what's the turnover rate been like relative to what we saw earlier in 2017?

John D. McDermott  
*Chief Executive Officer & Director, Endologix, Inc.*

A

Yeah. I don't think we've given our rep count OUS. We've talked about it in the U.S. and we're still at that 110 reps and clinical specialists in the U.S. And that – I think that's a good number for at least the next year, as what we would expect. And the turnover has been actually more consistent with historical numbers. We had an increased turnover over the summer. That has settled down dramatically, and we're kind of back into what I would consider more of a normalized run rate with turnover. It's not zero, but it's at a low rate now.

Chris Pasquale  
*Analyst, Guggenheim Securities LLC*

Q

Great. Thanks.

**Operator:** There are no further questions. I'd like to turn the call back over to management for closing comments.

John D. McDermott  
*Chief Executive Officer & Director, Endologix, Inc.*

All right. Well, thank you, everyone, for joining us on the call this afternoon and your interest in Endologix. It's been a pleasure interacting with you over the past 10 years, and I wish you great success in the future. Have a good evening.

**Operator:** This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation, and have a wonderful day.

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