01-Apr-2019

Endologix, Inc. (ELGX)

Business Update Call

CORPORATE PARTICIPANTS

John Onopchenko
Chief Executive Officer & Director, Endologix, Inc.

Vaseem Mahboob
Chief Financial Officer, Endologix, Inc.

OTHER PARTICIPANTS

Chris Pasquale
Analyst, Guggenheim Securities LLC

Mathew Justin Blackman
Analyst, Stifel, Nicolaus & Co., Inc.

Matthew Henriksson
Analyst, BMO Capital Markets (United States)

Kevin M. Farshchi
Analyst, Piper Jaffray & Co.

Jaime Lynn Morgan
Analyst, SVB Leerink LLC

MANAGEMENT DISCUSSION SECTION

Operator: Greetings, and welcome to Endologix 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. And the webcast replay of the call will be available at the same site approximately one hour at 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 management – within the meaning of federal security laws. 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 discussion of risk factors, we encourage you to review the Endologix Annual Report on Form 10-K filed with the Securities and Exchange Commission this morning, and subsequent reports as filed by the company with the Securities and Exchange Commission.

Furthermore, the contents of this conference call contain time-sensitive information that is accurate only as of the date of the live broadcast, April 1, 2019. Endologix undertakes no obligation to revise or update any statements to reflect events or circumstances after the date of this call.

With that said, I would now like to turn the call over to John Onopchenko, Endologix's Chief Executive Officer. Thank you. You may begin.

John Onopchenko

Chief Executive Officer & Director, Endologix, Inc.

Thank you, operator, and good morning, everyone. Thank you for joining us on short notice. Today, I am pleased to announce another step forward in the Endologix story, as we continue to make progress on the strategic vision that we outlined for you nearly a year ago. This morning we announced our entry into definitive agreements representing a number of significant financing transactions, including a $50 million equity raise and the refinancing of our convertible debt. We anticipate that these transactions, which are subject to customary closing conditions, will be effective on Wednesday, April 3.

Speaking prospectively, we believe these transactions will provide us with much needed financial flexibility and further reduces the risk attributed to our debt, enabling us to continue our unwavering pursuit of product innovation and clinical excellence to advance our mission of category leading EVAR outcomes for patients with AAA.

Before handing the call over to Vaseem, I would like to sincerely thank our partners in these transactions, as well as the wonderful members of our team here at Endologix for their ongoing persistence and dedication. Accountability has enabled a remarkable change in our culture and the deal team at Endologix stands as a shining example of that valuable cultural attribute.

I will now pass the call over to Vaseem to walk you through the transactions in greater detail. Vaseem?

Vaseem Mahboob

Chief Financial Officer, Endologix, Inc.

Thank you, John and good morning, everyone. Before I proceed, I want to remind listeners that we have posted a supplemental slide deck on our Investor Relations website directly below the webcast link, so that you can follow along during my remarks. As John mentioned, we are very pleased to announce our entry into definitive agreements representing the transactions I'm about to review.

These new equity financing and debt restructuring transactions will significantly strengthen our balance sheet by providing us with greater liquidity, while simultaneously reducing our debt risk and easing a number of our financial covenants. These are necessary steps to improve the strength of our balance sheet and will serve to support our path to achieving operating cash flow breakeven by 2021.

I will now walk you through a description of the three main elements of this overall cash infusion and debt restructuring transaction. First, the new equity raise; second, the 2020 convertible note exchange; and third, the restructuring of our August 2018 deal with Deerfield.

Starting with the equity raise, this morning we announced that we have entered into a purchase agreement to sell roughly 7.9 million shares of common stock at an offering price of $6.61, which equates to gross proceeds of roughly $52 million in new capital for the company's balance sheet. This equity raise was part of a syndicate that included one of our top five equity holders, five new investors including an equity investment from Deerfield, and certain members of the Endologix management team and Board of Directors. The company's net proceeds after payment of estimated finance advisor fees, but before other transaction expenses, is expected to be approximately $49 million.

Turning to the second key element, our two largest convertible note holders have agreed to exchange approximately $73 million of our existing 3.25% 2020 convertible notes for approximately $67 million of new 5%

convertible senior notes due in 2024. The exchanging holders will receive $900 in principal for every $1,000 in principal of the existing notes, resulting in debt extinguishment of approximately $6.3 million. The new notes will consist of a $25 million mandatory convertible note and a roughly $42 million voluntary convertible note. The mandatory convertible notes provide for the potential conversion of up to $25 million of the note amounts into Endologix stock at a price of $6.61 over the next 15 months, subject to certain conditions, including meeting the threshold stock price, compliance with any equity ownership blockers and similar conditions.

The voluntary convertible notes can convert at a 25% premium to the offering price of the deal, also subject to certain conditions precedent. We plan to address the remaining unexchanged stub of $11.1 million at or before the notes mature in late 2020. This exchange debt has represented a significant overhang on our balance sheet and will be eliminated as a result of these transactions.

Turning to the third key element, in order to facilitate the new equity raise, we focused on three aspects of the Deerfield debt deal that was signed in August of 2018. First, the equity investors wanted to see a relaxation of the financial covenants. This will be accomplished by amendments to our agreements with Deerfield, lowering the 2019 trailing 12-month revenue test from $130 million to $119 million and lowering the 2020 to 2023 trailing 12-month revenue covenant to $129 million, down from the prior covenant of $140 million.

I want to stress the fact that lowering of these revenue covenants is in no way meant to signal any changes to our business outlook or our guidance for 2019. We believe that our business fundamentals continue to improve as we make progress towards our vision that we outlined at the October 2 Investor Meeting. So despite the lower covenants, we are not changing our full year revenue guidance of at least $140 million, and today, announced our preliminary first quarter revenues of at least $35 million, which is consistent with our guidance we provided at JPMorgan.

We will also lower our global excess liquidity covenant from $22.5 million to $17.5 million, while also eliminating the $200 million market cap provision in our revolver with Deerfield which had previously prevented us from tapping into our inventory borrowing base. This change in provision grants us access to an approximately $20 million of borrowing base as of the closing date. Overall, we are very confident that the newly negotiated covenants represent a significant risk reduction. This will allow our management team to better focus on running the business and delivering on our goals of predictable and consistent results, creating innovative products supported by compelling clinical evidence, all resulting in durable profitable growth.

Second, we needed to address the first $40 million amortization payment that was due in April 2021. We have now pushed $20 million of that payment into 2022 and 2023 as highlighted on slide 5 of the supplemental deck. The remaining $20 million may be equitized in the following way: $4.2 million through a mandatory equitization mechanism and the remaining $15.8 million through either a Deerfield voluntary equitization or a force conversion by the company. These equitizations are subject to a number of conditions precedent including satisfaction of shared price threshold requirements, compliance with Deerfield's 4.9875% ownership blocker and other conditions as set forth in the transaction agreements. We are confident that these changes will squarely address this amortization payment risk.

The third goal as it relates to the Deerfield debt facility was to delever the company over time and as laid out on slide 8, through the three mechanisms of mandatory, voluntary and forced conversions, there is the potential to reduce the debt burden by swapping debt for equity at prices that are equal or higher than the equity offering price of $6.62. In return for the accommodations from Deerfield that I just mentioned, we agreed to restrike their existing 1.4 million warrants to $6.61 and also agreed to an additional final fee of $5 million to be paid at maturity.

The three key drivers of incremental share issuance from this transaction in the next 15 months are as follows. First, the new equity raise of roughly $52 million and 7.9 million shares. Second, the mandatory conversion of up to $25 million from the new convertible note at $6.61 of roughly 3.8 million shares. The mandatory conversion of up to $25 million of the first out waterfall loan to Deerfield at $6.62 of roughly 3.8 million shares. The mandatory conversions were structured to be capped to roughly 500,000 shares of new issuance per month over the next 15 months. These mandatory conversions and other mechanisms are subject to a conditions precedent and I would direct your attention to our 8-K.

Lastly I would like to echo John's comments thanking our partners for a job well done and would like to add that I'm very proud of our team for all of their hard work in getting these transactions documented and signed.

Looking ahead, we remain committed to managing our operating expenses in accordance with our strategic plan while continuing to make [ph] thoughtful (12:26) investments in R&D, clinical development and focusing on the continued improvement of our commercial productivity as we serve the AAA market.

With that, I would like to turn it back to John to discuss the key catalysts for the company this year. John?

John Onopchenko

Chief Executive Officer & Director, Endologix, Inc.

Thank you, Vaseem. Having addressed the balance sheet issues in building of a cash balance that bridges us to cash flow breakeven in 2021, I'm going to take a few minutes to reiterate the key catalysts for the remainder of the year as listed on slide 14 in the supplemental deck.

We expect to get approval from the FDA on our ChEVAS IDE and also begin enrollment. We are also expecting in the second half to return to year-over-year growth on the heels of the stable U.S. AFX2 business. We also expect to finish enrollment in our EVAS2 Nellix IDE. And finally we expect to receive FDA approval for Ovation Alto which will be a key growth driver for the company in 2020.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question is from Chris Pasquale with Guggenheim. Please proceed.

Chris Pasquale
Analyst, Guggenheim Securities LLC
Q

Thanks. Good morning guys.

John Onopchenko
Chief Executive Officer & Director, Endologix, Inc.
A

Hey, Chris.

Chris Pasquale
Analyst, Guggenheim Securities LLC
Q

So Vaseem I just wanted to confirm the comments around targeting operating cash flow breakeven by 2021. Do you believe that this round of financing gets you there or is there still a gap to bridge?

Vaseem Mahboob
Chief Financial Officer, Endologix, Inc.
A

No. Chris, we've done a lot of scenario planning and we feel really confident that based on the projections for this year, the work that we have done on restructuring of the business and really bending the curve on our operating expenses and the expectations on a full year launch of Alto in 2021, we're very confident that we can get to cash flow breakeven. And that this financing represents that bridge to that cash flow breakeven in the second half of 2021.

Chris Pasquale
Analyst, Guggenheim Securities LLC
Q

Okay. And there's a lot of potential equity conversion mentioned here. You noted Deerfield has a 5% ownership blocker. What would – just the mandatory conversion pieces, how close to those ownership thresholds would just the mandatory pieces take you and what's the likelihood that the voluntary conversions are going to be available?

Vaseem Mahboob
Chief Financial Officer, Endologix, Inc.
A

Well, so it's a great question and I think that's why we gave you a very high level look on the dilution calculation here, because obviously there's a lot of conditions precedent and blockers that are different from one investor to the other. So what we try to do out here is give you those three big drivers of the mandatory conversions that we know potentially can happen between the converts and Deerfield, but I think it will be – it remains to be seen on what the actual dilutions will be and it's very difficult to model that out Chris.

But at the same time, listen, I think everybody will kind of go through the contract, the 8-K and make the determination on what the dilution rates are going to be, but what we can say with certainty is that the equity raise drives the 7.8 million share dilution and then you got the 3.8 million with Deerfield and the 3.8 million for the convertible notes that can happen in the next [ph] $25 million (16:23) and that's an assumption and will have to actually see how those plays out relative to the conditions and the thresholds for all of the different investors here in the syndicate.

Chris Pasquale
Analyst, Guggenheim Securities LLC

Q

All right. Thank you.

Vaseem Mahboob
Chief Financial Officer, Endologix, Inc.

A

Yeah.

Operator: Our next question is from Mat Blackman with Stifel. Please proceed.

Mathew Justin Blackman
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Thanks, and good morning, everyone. Vaseem, maybe I was hoping maybe you could go over that one more time on the capital structure. I just want to make sure I'm getting all these moving parts right. So if I think about the pro forma share count in the first quarter, we're talking about adding the 8 million from the equity issuance and then the 3.8 million for the new convert, but not the 3.8 million from the potentially voluntary portion of the convert. Just help me with where that pro forma 1Q share count [ph] just were to (17:13) shake out.

Vaseem Mahboob
Chief Financial Officer, Endologix, Inc.

A

Listen we have about 10.3 million shares outstanding. And what we are saying here is that when the deal closes here on April 3, we would have about 7.9 million share dilution that will happen because of the equity raise of $52 million at $6.61 and then you have the two mandatory conversions that will happen over the next literally 15 months and subject to conditions that are set out in the contract. So when you look at if all of the mandatory conversions happen, the $25 million for Deerfield and the $25 million for the convertible note holders, you end up with another 3.8 million and 3.8 million, so there's another [ph] $7.6 million (18:01) of dilution.

Mathew Justin Blackman
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. That's where I was coming out to. And then, help me with the math on the new pro forma debt balance in the first quarter. I'm getting to roughly $190 million but that doesn't seem to jive with the pro forma stack of close to $250 million on slide 6. Just help me understand where the new sort of total debt position will be? And then I just have a couple of quick follow-ups.

Vaseem Mahboob
Chief Financial Officer, Endologix, Inc.

A

So, the real debt extinguishment at the time of the transaction is going to be the fact that we're going to pay out the convert holders at $0.90 for the debt they have. So that's about $6.3 million reduction. The rest of it is all going to happen over time, Mat. And the $6 million – $15 million will happen over the next 15 months. The $92 million will happen through the voluntary conversions and they actually start on July 1, 2020. So till then that doesn't start to move. So really the actual change in the debt as of the closing here is going to be that $6.3 million reduction and then the equitizations kick in.

Mathew Justin Blackman
Analyst, Stifel, Nicolaus & Co., Inc. Q

Okay.

Vaseem Mahboob
Chief Financial Officer, Endologix, Inc. A

So, it's all laid out on – it's all laid out in the Endologix debt stack chart...

John Onopchenko
Chief Executive Officer & Director, Endologix, Inc. A

Slide 6.

Vaseem Mahboob
Chief Financial Officer, Endologix, Inc. A

...slide 6 in the deck.

Mathew Justin Blackman
Analyst, Stifel, Nicolaus & Co., Inc. Q

Yeah. No, I see that. All right, I got it. And then the last two quick ones, and maybe, John, with the balance sheet now shored up, it's kind of behind you, what does this potentially free you up to do either from an investment standpoint, understanding that you're trying to watch your spend, but maybe where your hands were tied perhaps before where now you can perhaps put some money work to drive the business? And I guess just to the last question in, I know, and I'm sure you don't have full details on the first quarter yet, but suffice to say the sort of same similar drivers of upside that we've seen in the prior last several quarters? Any help there will be greatly appreciated. Thanks, guys.

John Onopchenko
Chief Executive Officer & Director, Endologix, Inc. A

Sure, Mat. Thank you. First, we are making no changes to our strategic plan or as importantly the practices that we've established in the way we discipline our spend. This balance sheet improvement simply allows us to operate with the flexibility and now critical focus on exclusively the business. It is – it is -we've done the right work in laying out what it is that we think we're going to need to do from a spend basis in order to get us to that cash independence by 2021. Could there be things that opportunistically appear before us that we would need to evaluate and put through the appropriate criteria in terms of incremental spend? Sure. But, at this point, there are no immediate plans to do that. It's in essence continuing to advance the work that we started last year and in essence hit our cash independent state.

Mathew Justin Blackman
Analyst, Stifel, Nicolaus & Co., Inc. Q

Yeah.

Vaseem Mahboob
Chief Financial Officer, Endologix, Inc. A

And then on the second part of it, Mat, listen on the – we did preannounce the revenues preliminary of $35 – at least $35 million and very consistent with what we had said at JPMorgan. We continue to make good progress on the U.S. rep stability. The impact of the FSNs we think is mostly behind us and we are starting to kind of come out of that J curve on the other side and we expect to see sequential growth from here on out into the rest of 2019. So really positive and encouraging signs here in the first quarter from where we were at JPMorgan. So we continue to make progress.

Mathew Justin Blackman
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Thank you guys and congratulations.

Vaseem Mahboob
Chief Financial Officer, Endologix, Inc.
A

Thanks.

John Onopchenko
Chief Executive Officer & Director, Endologix, Inc.
A

Thanks, Mat.

Operator: Our next question is from Joanne Wuensch with BMO Capital Markets. Please proceed.

Matthew Henriksson
Analyst, BMO Capital Markets (United States)
Q

Yes. Hi. This is Matt Henriksson in for Joanne. Good morning everyone. Just with regards to the Deerfield facility and the voluntary conversion, can you just walk through in a little more details about when you could expect to see some of that conversion take place and how that could impact the cash outflows from your pro forma amortization schedule?

Vaseem Mahboob
Chief Financial Officer, Endologix, Inc.
A

Sure. So there's a slide in the deck here on slide 9, Matt, in the supplemental deck. So if you can see on that chart, we have laid out on the left-hand side the original facility agreement for the $160 million and what the amortization payments were. And then, we're showing you the amended facility agreement that reflects the equitization and also the push outs of some of the amortization payment.

So really when you look at the second column, that shows you kind of the new amortization schedule, and then how the $25 million of the mandatory conversion over the next 15 months will, on a pro rata basis, take it down. So you can see the 2021 amortization payment goes down $4.17 million, the 2022 goes down $10.42 million and then the 2023 amortization payment goes down $10.4 million. So really what you're left with is the $135.5 million.

Matthew Henriksson
Analyst, BMO Capital Markets (United States)
Q

Okay. But just to dive in a little bit deeper, because I'm looking at that slide as well. But I'm looking at that $15.83 million that remains following the mandatory conversion. Should we consider that more as a cash outflow or can that $50 million voluntary conversion help reduce that cash outflow as well?

Vaseem Mahboob
Chief Financial Officer, Endologix, Inc.
A

That's great. So the first $25 million is laid out on the chart. But if you go back to the previous page, you can also see the $50 million of the voluntary conversion. So that voluntary conversion will be at the option of Deerfield. But we also have what we call forced conversion that as long as the equity price is north of 175% of the closing price, that we can actually force the conversion [ph] there at (24:31) 15% discount to address those. So no, that will not be cash out of the door from the company, we will use the equitization mechanism here to pay that down.

Matthew Henriksson
Analyst, BMO Capital Markets (United States) Q

Okay. That was it for me. Thank you, guys.

Vaseem Mahboob
Chief Financial Officer, Endologix, Inc. A

All right. Thanks, Matt.

Operator: Our next question is from Matt O'Brien with Piper Jaffray. Please proceed.

Kevin M. Farshchi
Analyst, Piper Jaffray & Co. Q

Thanks, guys. This is Kevin on for Matt today.

John Onopchenko
Chief Executive Officer & Director, Endologix, Inc. A

Hey, Kevin.

Kevin M. Farshchi
Analyst, Piper Jaffray & Co. Q

I had a question – thanks. I had a question on the healthier balance sheet you've got this equity in, as these conversions start to happen, I guess I'll ask both at the same time, how do you expect the cash burn to trend in 2019, if you've modeled it out internally? And then following up on the spend commentary, you don't have covenants on OpEx after 2020. So curious what that burn rate looks like given the fact that you have some more flexibility to spend and capture more growth and hire more people when you have Alto, just thinking about the long-term as well.

Vaseem Mahboob
Chief Financial Officer, Endologix, Inc. A

No, Kevin, so I think you picked up on the structure on how the contract was amended and I think that's exactly how we were thinking about it too. So one, we feel really good about what we have communicated for 2019, which is to get our cash burn down to $20 million for the year, exit the fourth quarter with a cash burn of less than $5 million. So feel really confident about that.

The second piece of it is that there's no more OpEx covenants for 2020, that was really, from a [ph] design principles (26:08) perspective, meant to give us some flexibility [ph] invest (26:13) back in the business, and as there are opportunities available, so that we can capitalize on those.

But, at the same time, I'm going to echo what John just said, yeah, we have $50 million more of cash on the balance sheet, but we want to be very frugal, we want to be very mindful and purposeful on how we deploy that capital and really focus on what we communicated at the October 2 Investor Day and the priorities that we laid out. So the goal here is not to go Student Body Left and start to work on other projects, it's really to make sure that we run the company and focus on the priorities that we have set out, because we know that those set of priorities that we have laid out really help us create some long-term shareholder value and get these therapies to market.

So all-in-all, this has been designed to give us the flexibility should opportunities persist and not allow us to kind of be pigeonholed into a OpEx number, but we would be very mindful of the cash needs of the business and on the 2019 basis, listen it's too early to put out guidance for 2019. But we don't expect our cash burn to exceed that $20 million in outer years considering what we have put out on our strategic roadmap so far.

Kevin M. Farshchi
Analyst, Piper Jaffray & Co.

Q

Thank you so much. That's really helpful. Thank you.

John Onopchenko
Chief Executive Officer & Director, Endologix, Inc.

A

Okay. Thank you.

Operator: Our next question is from Richard Newitter with SVP Leerink. Please proceed.

Jaime Lynn Morgan
Analyst, SVB Leerink LLC

Q

Hi. This is Jaime on for Rich. I guess a quick question, just a follow-up on some of the catalysts that you outlined. Could you just remind us what the timelines are for the ChEVAS study? I know on the fourth quarter call, you said you were planning to submit the design imminently. So have you guys submitted that, and just remind us of what the timelines and – around approval and enrollment are? Thanks.

Vaseem Mahboob
Chief Financial Officer, Endologix, Inc.

A

Yeah, so, yes, we had talked about the ChEVAS IDE and as we had said, we are on track to get the approval from the FDA on that here in the first half of the year. And again, we'll give you more details as we get more feedback from the FDA, but it's on track here, Jaime. So no change to what we had communicated in the past.

John Onopchenko
Chief Executive Officer & Director, Endologix, Inc.

A

And to be clear, Jaime, yes, it has been submitted.

Vaseem Mahboob
Chief Financial Officer, Endologix, Inc.

A

Yes.

Jaime Lynn Morgan
Analyst, SVB Leerink LLC

Q

Okay, great. Thanks.

Operator: [Operator Instructions] Our next question is from Robbie Marcus with JPMorgan. Please proceed.

Q

Hi. This is [ph] Alan. Actually Alan (28:49) on for Robbie. I guess...

John Onopchenko
Chief Executive Officer & Director, Endologix, Inc.

A

Hey [ph] Alan (28:52)

Q

...I might have missed this earlier, but looks like you kind of reported preliminary revenue of at least $35 million. That's – I guess like that's basically in line with kind of like the preannouncement, I guess. So maybe a little bit better, since it's at least $35 million. Can you kind of talk through the drivers of kind of maybe what drove a little bit of a better quarter than expected, and how that kind of sets you up for the rest of the year?

Vaseem Mahboob
Chief Financial Officer, Endologix, Inc.

A

Sure. So [ph] Alan (29:17), a little bit too early to kind of get into the details on how Ovation did and how AFX did and kind of OUS, U.S. dynamics. But – and, of course, read here, when we look at the trends here, I think they're very consistent with what we had said at JPMorgan. We continue to see U.S. AFX in line with expectations and Ovation as expected and as you saw the number at least $35 million is very consistent with that $35 million guide we put out. So, listen, we give you more color and more details on where – what are kind of the key takeaways from the first quarter at the earnings call which is scheduled here not too far away in early May. But we are really, really happy to see the progress that we make and as we have said in the past, listen we don't see any big changes to our commercial footprint. All of the restructuring activities that happened last year are starting to kind of bear fruit. And the team is stable and we didn't see any attrition. So listen we're very confident on where we are today and we feel that we're on the other side of the J curve here and we'll continue to make sequential progress here from Q1 into Q2, Q3 and Q4.

Q

Got it. Thank you.

Vaseem Mahboob
Chief Financial Officer, Endologix, Inc.

A

Yeah.

Operator: We have reached the end of our question-and-answer session. I would like to turn the conference back over to management for closing remarks.

John Onopchenko

Chief Executive Officer & Director, Endologix, Inc.

Again, I want to thank all of you for jumping on the call this morning at a very short notice. I want to again reiterate our thank you from all of our partners that enabled this transaction to happen and lastly, but certainly not in the least, of the hard work that the team here at Endologix enacted in order to bring this much needed financing in sort of transactions to close. Thank you, operator.

Operator: Thank you. This concludes today's conference. You may disconnect your lines at this time and thank you for your participation.