GLOBUS MEDICAL INC
Form 10-Q
August 02, 2018
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2018
Or
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ______________ to _______________

Commission File No. 001-35621

GLOBUS MEDICAL, INC.
(Exact name of registrant as specified in its charter)

DELAWARE	04-3744954
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
2560 General Armistead Avenue, Audubon, PA 19403	(610) 930-1800
(Address of principal executive offices) (Zip Code)	(Registrant’s telephone number, including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days:
Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files):
Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act:

Large Accelerated Filer	x	Accelerated Filer	¨	Non-accelerated Filer (Do not check if a smaller reporting company)	¨	Smaller Reporting Company	¨	Emerging Growth Company	¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act):

Yes ¨ No x

The number of shares outstanding of the issuer’s common stock (par value $0.001 per share) as of July 31, 2018 was 98,254,456 shares.

Table of Contents

GLOBUS MEDICAL, INC. AND SUBSIDIARIES
TABLE OF CONTENTS

Table of Contents

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

GLOBUS MEDICAL, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

(In thousands, except par value)	June 30, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$119,944	$118,817
Short-term marketable securities	240,976	254,890
Accounts receivable, net of allowances of $3,924 and $3,963, respectively	118,561	116,676
Inventories	114,758	108,409
Prepaid expenses and other current assets	16,943	11,166
Current portion of note receivable	3,333	1,667
Income taxes receivable	18,709	8,717
Total current assets	633,224	620,342
Property and equipment, net of accumulated depreciation of $204,760 and $191,760, respectively	154,342	143,167
Long-term marketable securities	155,859	56,133
Note receivable	26,667	28,333
Intangible assets, net	74,973	78,659
Goodwill	123,750	123,890
Other assets	7,202	7,947
Deferred income taxes	17,816	20,031
Total assets	$1,193,833	$1,078,502
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$20,727	$25,039
Accrued expenses	47,978	52,594
Income taxes payable	2,979	3,274
Business acquisition liabilities	6,507	11,411
Deferred revenue	2,089	755
Total current liabilities	80,280	93,073
Business acquisition liabilities, net of current portion	3,815	4,508
Deferred income taxes	9,991	10,669
Other liabilities	2,561	2,474
Total liabilities	96,647	110,724
Commitments and contingencies (Note 13)		
Equity:		
Class A common stock; $0.001 par value. Authorized 500,000 shares; issued and outstanding 74,370 and 72,780 shares at June 30, 2018 and December 31, 2017, respectively	74	73
Class B common stock; $0.001 par value. Authorized 275,000 shares; issued and outstanding 23,878 at June 30, 2018 and December 31, 2017, respectively	24	24
Additional paid-in capital	283,132	238,341
Accumulated other comprehensive loss	(6,807)	(6,907)

Retained earnings	820,763	736,247
Total equity	1,097,186	967,778
Total liabilities and equity	$ 1,193,833	$ 1,078,502

See accompanying notes to condensed consolidated financial statements.

3

Table of Contents

GLOBUS MEDICAL, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

(In thousands, except per share amounts)	Three Months Ended		Six Months Ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Sales	$173,384	$152,390	$347,795	$308,199
Cost of goods sold	37,637	37,199	75,607	72,799
Gross profit	135,747	115,191	272,188	235,400
Operating expenses:				
Research and development	13,523	10,713	26,210	21,379
Selling, general and administrative	77,125	64,438	152,819	131,497
Provision for litigation	—	243	—	243
Amortization of intangibles	2,178	1,809	4,365	3,591
Acquisition related costs	782	617	1,021	1,005
Total operating expenses	93,608	77,820	184,415	157,715
Operating income	42,139	37,371	87,773	77,685
Other income, net				
Interest income/(expense), net	2,971	1,590	5,262	3,008
Foreign currency transaction gain/(loss)	344	448	339	996
Other income/(loss)	4,850	148	5,008	282
Total other income/(expense), net	8,165	2,186	10,609	4,286
Income before income taxes	50,304	39,557	98,382	81,971
Income tax provision	5,327	10,890	13,866	24,590
Net income	$44,977	$28,667	$84,516	$57,381
Earnings per share:				
Basic	$0.46	$0.30	$0.87	$0.60
Diluted	$0.44	$0.29	$0.84	$0.59
Weighted average shares outstanding:				
Basic	97,830	96,161	97,337	96,079
Dilutive stock options	3,680	1,657	3,668	1,404
Diluted	101,510	97,818	101,005	97,483
Anti-dilutive stock options excluded from weighted average calculation	1,809	2,017	1,863	3,887

See accompanying notes to condensed consolidated financial statements.

Table of Contents

GLOBUS MEDICAL, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

(In thousands)	Three Months Ended		Six Months Ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Net income	$44,977	$28,667	$84,516	$57,381
Other comprehensive income/(loss):				
Unrealized gain/(loss) on marketable securities, net of tax	164	23	(72)	143
Foreign currency translation gain/(loss)	(4,205)	186	172	2,627
Total other comprehensive income/(loss)	(4,041)	209	100	2,770
Comprehensive income	$40,936	$28,876	$84,616	$60,151

See accompanying notes to condensed consolidated financial statements.

Table of Contents

GLOBUS MEDICAL, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(In thousands)	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017
Cash flows from operating activities:		
Net income	$84,516	$57,381
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	19,233	22,935
Amortization of premium on marketable securities	1,477	1,855
Write-down for excess and obsolete inventories	5,406	4,962
Stock-based compensation expense	11,533	7,062
Allowance for doubtful accounts	312	958
Change in fair value of business acquisition liabilities	416	811
Change in deferred income taxes	1,429	(4,238)
(Gain)/loss on disposal of assets, net	(3,947)	—
(Increase)/decrease in:		
Accounts receivable	(2,257)	(3,172)
Inventories	(11,120)	(4,652)
Prepaid expenses and other assets	(3,303)	8,506
Increase/(decrease) in:		
Accounts payable	(5,751)	(1,660)
Accrued expenses and other liabilities	(2,104)	(4,497)
Income taxes payable/receivable	(10,276)	(6,825)
Net cash provided by operating activities	85,564	79,426
Cash flows from investing activities:		
Purchases of marketable securities	(309,223)	(138,286)
Maturities of marketable securities	158,102	103,398
Sales of marketable securities	63,741	32,688
Purchases of property and equipment	(27,167)	(25,061)
Proceeds from sale of assets	3,000	—
Acquisition of businesses, net of cash acquired	—	(31,501)
Net cash used in investing activities	(111,547)	(58,762)
Cash flows from financing activities:		
Payment of business acquisition liabilities	(5,950)	(5,234)
Proceeds from exercise of stock options	33,131	5,911
Net cash provided by financing activities	27,181	677
Effect of foreign exchange rate on cash	(71)	450
Net increase in cash, cash equivalents, and restricted cash	1,127	21,791
Cash, cash equivalents, and restricted cash at beginning of period	118,817	67,431
Cash, cash equivalents, and restricted cash at end of period	$119,944	$89,222
Supplemental disclosures of cash flow information:		
Interest paid	—	21
Income taxes paid	$22,667	$35,475

See accompanying notes to condensed consolidated financial statements.

GLOBUS MEDICAL, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1. BACKGROUND AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) The Company

Globus Medical, Inc., together with its subsidiaries, is a medical device company that develops and commercializes solutions for the treatment of musculoskeletal disorders. We are primarily focused on implants that promote healing in patients with spine disorders, but recently launched a robotic guidance and navigation system and products to treat patients who have experienced orthopedic traumas.

We are an engineering-driven company with a history of rapidly developing and commercializing advanced products and procedures that assist surgeons in effectively treating their patients, respond to evolving surgeon needs and address new treatment options. Since our inception in 2003, we have launched over 180 products and offer a comprehensive portfolio of innovative and differentiated products addressing a broad array of spinal pathologies, anatomies and surgical approaches.

We are headquartered in Audubon, Pennsylvania, and market and sell our products through our exclusive sales force in the United States, as well as within North, Central & South America, Europe, Asia, Africa and Australia. The sales force consists of direct sales representatives and distributor sales representatives employed by exclusive independent distributors.

The terms the “Company,” “Globus,” “we,” “us” and “our” refer to Globus Medical, Inc. and, where applicable, our consolidat subsidiaries.

(b) Basis of Presentation

The accompanying interim unaudited condensed consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles (“U.S. GAAP”) for interim financial statements and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in complete financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). As such, the information included in this Quarterly Report on Form 10-Q should be read in conjunction with the consolidated financial statements and accompanying footnotes included in our Annual Report on Form 10-K for the year ended December 31, 2017.

In the opinion of management, the statements include all adjustments necessary, which are of a normal and recurring nature, for the fair presentation of our financial position and of the results for the three- and six- month periods presented. The results of operations for any interim period are not indicative of results for the full year.

During the fourth quarter of 2017, the Company identified and recorded an adjustment to its December 31, 2016 consolidated balance sheet to correct the presentation of $65.8 million of its Variable Rate Demand Notes (“VRDNs”) as short-term marketable securities instead of cash and cash equivalents. Accordingly, the statement of cash flows for the year ended December 31, 2016 has been adjusted to appropriately increase purchases of marketable securities by $63.3 million, resulting in an increase in net cash used in investing activities and a decrease to cash and cash equivalents, end of period of $63.3 million. The statement of cash flows for the year ended December 31, 2015 has been adjusted to appropriately increase purchases of marketable securities by $2.5 million, resulting in an increase in net cash used in investing activities and a decrease to cash and cash equivalents, end of period of $2.5 million. The statement of cash flows for the six months ended June 30, 2017 has been adjusted to appropriately increase purchases of marketable securities, maturities of marketable securities and sales of marketable securities by $19.1 million, $0.7 million and $23.2 million respectively, resulting in a decrease in net cash used in investing activities and an increase to cash and cash equivalents, end of period of $4.8 million.

In accordance with FASB Topic ASC 320, Investments-Debt and Equity Securities, based on our ability to market and sell these instruments and our intent to not hold such instruments until maturity, we account for VRDNs as available-for-sale, and carry them at their fair value. VRDNs are similar to short-term debt instruments because their interest rates are reset periodically. Investments in these securities can be sold for cash on the auction date. We classified VRDNs at June 30, 2017 as short-term based on the reset dates. The Company did not own VRDNs as of December 31, 2017 and does not own VRDNs as of June 30, 2018.

(c) Principles of Consolidation

The accompanying condensed consolidated financial statements include the accounts of Globus and its wholly-owned subsidiaries. All intercompany balances and transactions are eliminated in consolidation.

(d) Use of Estimates

The preparation of the condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. We base our estimates, in part, on historical experience that management believes to be reasonable under the circumstances. Actual results could differ from those estimates. Estimates and assumptions are periodically reviewed and the effects of revisions are reflected in the condensed consolidated financial statements in the period they are determined to be necessary.

Significant areas that require management’s estimates include intangible assets, business acquisition liabilities, allowance for doubtful accounts, stock-based compensation, write-down for excess and obsolete inventory, useful lives of assets, the outcome of litigation, recoverability of intangible assets and income taxes. We are subject to risks and uncertainties due to changes in the healthcare environment, regulatory oversight, competition, and legislation that may cause actual results to differ from estimated results.

GLOBUS MEDICAL, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

During fourth quarter of 2017, we completed a review of the estimated useful life of our Instruments and Modules and cases. Based on historical useful life information, forecasted product life cycles and demand expectations, the useful life of Instruments and Modules and cases was extended from three to five years. This was accounted for as a change in accounting estimate and was made on a prospective basis effective October 1, 2017. For the three months ended June 30, 2018, depreciation expense was lower by approximately $1.5 million than it would have been had the useful life of these assets not been extended. The effect of this change on basic and diluted earnings per share for the three months ended June 30, 2018 was $0.01 per share. For the six months ended June 30, 2018, depreciation expense was lower by approximately $3.1 million with a diluted earnings per share impact of $0.03 per share.

(e) Cash, Cash Equivalents, and Restricted Cash

The following table provides a reconciliation of cash, cash equivalents, and restricted cash reported within the statement of financial position that sum to the total of the same such amounts shown in the statement of cash flows:

(In thousands)	June 30, 2018	December 31, 2017	June 30, 2017	December 31, 2016
Cash and cash equivalents	$119,944	$118,817	$88,744	$66,954
Restricted cash	—	—	478	477
Total cash, cash equivalents, and restricted cash as presented in the condensed consolidated statement of cash flows	$119,944	$118,817	$89,222	$67,431

(f) Marketable Securities

Our marketable securities include municipal bonds, corporate debt securities, commercial paper, securities of U.S. government-sponsored agencies and asset-backed securities, and are classified as available-for-sale as of June 30, 2018. Available-for-sale securities are recorded at fair value in both short-term and long-term marketable securities on our condensed consolidated balance sheets. The change in fair value for available-for-sale securities is recorded, net of taxes, as a component of accumulated other comprehensive income or loss on our condensed consolidated balance sheets. Premiums and discounts are recognized over the life of the related security as an adjustment to yield using the straight-line method. Realized gains or losses from the sale of our marketable securities are determined on a specific identification basis. Realized gains and losses, along with interest income and the amortization/accretion of premiums/discounts are included as a component of other income, net, on our condensed consolidated statements of income. Interest receivable is recorded as a component of prepaid expenses and other current assets on our condensed consolidated balance sheets.

We maintain a portfolio of various holdings, types and maturities, though most of the securities in our portfolio could be liquidated at minimal cost at any time. We invest in securities that meet or exceed standards as defined in our investment policy. Our policy also limits the amount of credit exposure to any one issue, issuer or type of security. We review our securities for other-than-temporary impairment at each reporting period. If an unrealized loss for any security is considered to be other-than-temporary, the loss will be recognized in our condensed consolidated statement of income in the period the determination is made.

GLOBUS MEDICAL, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

(g) Inventories

Inventories are stated at the lower of cost or net realizable value. Cost is determined on a first-in, first-out basis. The majority of our inventories are finished goods and we utilize both in-house manufacturing and third-party suppliers to source our products. We periodically evaluate the carrying value of our inventories in relation to our estimated forecast of product demand, which takes into consideration the estimated life cycle of product releases. When quantities on hand exceed estimated sales forecasts, we record a write-down for such excess inventories.

(h) Property and Equipment

Purchases of property and equipment included in accounts payable and accrued expenses were $6.8 million and $5.7 million during the six months ended June 30, 2018 and June 30, 2017, respectively.

(i) Revenue Recognition

Revenue is recognized upon transfer of control of promised products or services to customers in an amount that reflects the consideration we expect to receive in exchange for those products or services. Sales and other taxes we collect concurrent with revenue-producing activities are excluded from revenue. Incidental items that are immaterial in the context of the contract are recognized as expense. For purposes of disclosing disaggregated revenue, we disaggregate our revenue, into two categories, Spine and Emerging Technologies, based on the timing of revenue recognition. Our Spine products are comprised of our entire spinal implant portfolio, including traditional interbody fusion devices, our expandable cages, products designed for minimally invasive surgical techniques, motion preservation devices, regenerative biologics technologies and interventional pain management solutions. The majority of our Spine contracts have a single performance obligation and revenue is recognized at a point in time. Our Emerging Technology products consist of our imaging, navigational and robotic (“INR”) technologies and orthopedic trauma devices. The majority of our Emerging Technology product contracts typically contain multiple performance obligations, including maintenance and support, and revenue is recognized as we fulfill each performance obligation. For contracts with multiple performance obligations, we allocate the contract’s transaction price to each performance obligation using our best estimate of the standalone selling price of each distinct good or service in the contract. Our policy is to classify shipping and handling costs billed to customers as sales and the related expenses as cost of goods sold.

Nature of Products and Services

A significant portion of our Spine product revenue is generated from consigned inventory maintained at hospitals or with sales representatives. Revenue from the sale of consigned Spine products is recognized when we transfer control, which occurs at the time the product is used or implanted. For all other Spine product transactions, we recognize revenue when we transfer title to the goods, provided there are no remaining performance obligations that will affect the customer’s final acceptance of the sale. We use an observable price to determine the stand-alone selling price for the identified performance obligation.

Revenue from the sale of Emerging Technology products is generally recognized when title transfers to the customer which occurs at the time the product is delivered. Depending on the terms of the arrangement, we may also defer the recognition of a portion of the consideration received as we have to satisfy a future performance obligation to provide maintenance and support. We use an observable price to determine the stand-alone selling price for each separate performance obligation.

Contract Balances

Timing of revenue recognition may differ from the timing of invoicing to customers. We record a receivable when revenue is recognized prior to invoicing, or deferred revenue when revenue is recognized subsequent to invoicing. Deferred revenue is comprised mainly of unearned revenue related to the sales of certain Emerging Technology products, which includes maintenance and support services. Deferred revenue is generally invoiced annually at the beginning of each contract period and recognized ratably over the coverage period. For the three and six months ended June 30, 2018, there was an immaterial amount of revenue recognized from previously deferred revenue.

Disaggregation of Revenue

The following table represents total sales by revenue stream:

	Three Months Ended		Six Months Ended	
(In thousands)	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Spine products	$159,569	$152,390	$321,197	$308,199
Emerging Technology products	13,815	—	26,598	—
Total sales	$173,384	$152,390	$347,795	$308,199

(j) Other Income

On June 21, 2018, we sold assets for $5.0 million, of which $3.0 million was collected upon closing of the sale and the remaining $2.0 million recorded under prepaid expenses and other current assets in the accompanying condensed consolidated balance sheet.

(k) Recently Issued Accounting Pronouncements

In February 2016, the FASB released ASU 2016-02, Leases (Topic 842) (“ASU 2016-02”). Under ASU 2016-02, a right-of-use asset and lease obligation will be recorded for all leases with terms greater than 12 months, whether operating or financing, while the income statement will reflect lease expense for operating leases and amortization/interest expense for financing leases. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, with early adoption permitted, and requires the use of the modified retrospective method, which will require adjustment to all comparative periods presented in the consolidated financial statements. We are currently evaluating the impact of this update on our financial position, results of operations, and disclosures.

GLOBUS MEDICAL, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

In January 2017, the FASB released ASU 2017-04, Intangibles - Goodwill and Other (Topic 805): Simplifying the Test for Goodwill Impairment (“ASU 2017-04”), which eliminates the Step 2 calculation for the implied fair value of goodwill to measure a goodwill impairment charge. Under the updated standard, an entity will record an impairment charge based on the excess of a reporting unit’s carrying amount over its fair value. ASU 2017-04 does not change the guidance on completing Step 1 of the goodwill impairment test and still allows an entity to perform the optional qualitative goodwill impairment assessment before determining whether to proceed to Step 1. This update is effective for annual and interim goodwill impairment tests in fiscal years beginning after December 15, 2019 with early adoption permitted for any impairment test performed on testing dates after January 1, 2017. We are currently evaluating the timing and impact of the new standard on our financial position, results of operations and disclosures.

In February 2018, the FASB released ASU 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220), Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income (“ASU 2018-02”). Prior to ASU 2018-02, GAAP required the remeasurement of deferred tax assets and liabilities as a result of a change in tax laws or rates to be presented in net income from continuing operations, even in situations in which the related income tax effects of items in accumulated other comprehensive income were originally recognized in other comprehensive income. As a result, such items, referred to as stranded tax effects, did not reflect the appropriate tax rate. Under ASU 2018-02, entities are permitted, but not required, to reclassify from accumulated other comprehensive income to retained earnings those stranded tax effects resulting from the Tax Act. ASU 2018-02 is effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. We are currently evaluating the timing and impact of the new standard on our financial position, results of operations and disclosures.

In June 2018, the FASB released ASU 2018-07, Compensation—Stock Compensation (Topic 718), (“ASU 2018-07”), which expanded the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from nonemployees. ASU 2018-07 specifies that Topic 718 applies to all share-based payment transactions in which a grantor acquires goods or services to be used or consumed in a grantor’s own operations by issuing share-based payment awards. This update is effective for public entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. We are currently evaluating the timing and impact of the new standard on our financial position, results of operations and disclosures.

(l) Recently Adopted Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update 2014-09, Revenue from Contracts with Customers (Topic 606) (“ASU 2014-09”). ASU 2014-09 amends the guidance in former Topic 605, Revenue Recognition, and most other existing revenue guidance in US GAAP. Under the new standard, an entity will recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the payment to which the entity expects to be entitled in exchange for those goods or services and provide additional disclosures. As amended, the effective date for public entities is annual reporting periods beginning after December 15, 2017 and interim periods therein. We adopted the standard on January 1, 2018, using the modified retrospective method. We implemented internal controls and key system functionality to enable the preparation of financial information upon adoption. The adoption of this standard did not have a material impact on our financial position, results of operations, and disclosures.

In October 2016, the FASB released ASU 2016-16, Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory ("ASU 2016-16"). ASU 2016-16 removes the current exception in US GAAP prohibiting entities from recognizing current and deferred income tax expenses or benefits related to transfer of assets, other than inventory, within the consolidated entity. The current exception to defer the recognition of any tax impact on the transfer of inventory within the consolidated entity until it is sold to a third party remains unaffected. This update is effective for public entities for annual reporting periods beginning after December 15, 2017. We adopted ASU 2016-16 on January 1, 2018. This standard does not have a material impact on our financial position, results of operations, and disclosures.

In November 2016, the FASB released ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash ("ASU 2016-18"), which requires that amounts generally described as restricted cash and restricted cash equivalents be included with cash and cash equivalents when reconciling the total beginning and ending amounts for the periods shown on the statement of cash flows. Transfers between cash and cash equivalents and restricted cash and restricted cash equivalents will no longer be presented in the statement of cash flows. The amendments in this update should be applied using a retrospective transition method to each period presented. This update is effective for annual periods beginning after December 15, 2017, and interim periods within those fiscal years; early adoption is permitted, including adoption in an interim period. We adopted ASU 2016-18 on January 1, 2018. This standard does not have a material impact on our financial position, results of operations, and disclosures.

In January 2017, the FASB released ASU 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business ("ASU 2017-01"), which clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions or disposals of assets or businesses. The amendments in this ASU should be applied prospectively and are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, with early application permitted. No disclosures are required at transition. We adopted ASU 2017-01 on January 1, 2018. This standard does not have a material impact on our financial position, results of operations, and disclosures.

In May 2017, the FASB released ASU 2017-09, Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting ("ASU 2017-09"), which clarifies the changes to terms or conditions of a share based payment award that requires application of modification accounting under Topic 718. A change to an award should be accounted for as a modification unless the fair value of the modified award is the same as the original award, the vesting conditions do not change, and the classification as an equity or liability instrument does not change. This update is effective for annual reporting periods, and interim periods within those annual periods, beginning after December 15, 2017. Early application is permitted and prospective application is required for awards modified on or after the adoption date. We adopted ASU 2017-09 on January 1, 2018. This standard does not have a material impact on our financial position, results of operations, and disclosures.

GLOBUS MEDICAL, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

NOTE 2. ACQUISITIONS
KB Medical
On June 13, 2017, we acquired KB Medical SA (“KB Medical”), a Swiss-based robotic developer, to further bolster our development team, intellectual property, and product portfolio (the “KB Medical Acquisition”). We have included the financial results of KB Medical in our condensed consolidated financial statements from the acquisition date, and the results from KB Medical were not material to our condensed consolidated financial statements. We accounted for the KB Medical Acquisition under the purchase method of accounting. Amounts recognized for assets acquired and liabilities assumed are based on our purchase price allocations and on certain management judgments. These allocations are based on an analysis of the estimated fair values of assets acquired and liabilities assumed, including identifiable tangible assets, and estimates of the useful lives of tangible assets. The fair value of the consideration for the KB Medical Acquisition was approximately $31.5 million of cash paid at closing, plus a potential $4.9 million contingent consideration payment based on product development milestones. We recorded $20.2 million of identifiable net assets, based on their estimated fair values, and goodwill of $16.2 million. None of the goodwill is expected to be deductible for tax purposes.
As of June 30, 2018, the maximum aggregate undiscounted amount of contingent consideration potentially payable related to the KB Medical Acquisition is $5.0 million.
The table below represents the final purchase price allocation for the identifiable tangible and intangible assets and liabilities of KB Medical:

(In thousands)	
Consideration:	
Cash paid at closing	$31,501
Purchase price contingent consideration	4,871
Fair value of consideration	$36,372
Identifiable assets acquired and liabilities assumed:	
Cash acquired	$1,557
Prepaid and other current assets	168
Intangible assets, gross	24,500
Other assets	18
Accounts payable and accrued expenses	(1,312)
Deferred tax liabilities	(4,727)
Total identifiable net assets	20,204
Goodwill	16,168
Total allocated purchase price	$36,372

NOTE 3. NOTE RECEIVABLE

On September 1, 2016 (the “Closing Date”), in connection with the acquisition of the international operations and distribution channel of Alphatec Holdings, Inc. (“Alphatec International”), we entered into a Credit, Security and Guaranty Agreement (the “Credit Agreement”) with Alphatec Holdings, Inc. (“Alphatec”) and Alphatec Spine, Inc. (“Alphatec Spine” and together with Alphatec, the “Alphatec Borrowers”), pursuant to which we made available to the Alphatec Borrowers a senior secured term loan facility in an amount not to exceed $30.0 million. On the Closing Date, we made an initial loan of $25.0 million and the Alphatec Borrowers issued a note for such amount to us. On December 20, 2016, the remaining $5.0 million was drawn by the Alphatec Borrowers and added to the note.

The Credit Agreement contains customary operational and financial covenants, including a fixed charge coverage ratio to be maintained by the Alphatec Borrowers, and provides us with a security interest in all of the assets of the Alphatec Borrowers. The Credit Agreement has a scheduled maturity date five years from the Closing Date. The term loan interest rate for the first two years following the Closing Date is priced at the London Interbank Offered Rate (“LIBOR”) plus 8.0%, subject to a 9.5% floor. The term loan interest rate thereafter will be LIBOR plus 13.0%.

On March 30, 2017, we entered into a First Amendment to the Credit Agreement which modified the time periods during which the Alphatec Borrowers are required to calculate the fixed charge coverage ratio in order to determine compliance with the Credit Agreement. On March 8, 2018, we entered into a Consent, Joinder and Second Amendment pursuant to which, among other things, (i) we consented to the acquisition by Alphatec of SafeOp Surgical, Inc. (“SafeOp”), (ii) SafeOp joined the Credit Agreement as a “Borrower” thereunder, and (iii) we modified the time periods during which the Alphatec Borrowers (including SafeOp) are required to calculate the fixed charge coverage ratio in order to determine compliance with the Credit Agreement. The first period subject to compliance of the fixed charge coverage ratio is the month ended April 30, 2019.

Interest accrues on the note receivable based on the contractual terms of the note. We consider a note to be impaired when, based on current information or factors (such as payment history, value of collateral and assessment of the borrower’s current creditworthiness), it is probable that the principal and interest payments will not be collected according to the note agreement. As of June 30, 2018, we do not consider this note to be impaired. We believe that the note’s carrying value approximates its fair value.

GLOBUS MEDICAL, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

NOTE 4. GOODWILL AND INTANGIBLE ASSETS

A summary of intangible assets is presented below:

		June 30, 2018		
(In thousands)	Weighted Average Amortization Period (in years)	Gross Carrying Amount	Accumulated Amortization	Intangible Assets, net
In-process research & development	—	$19,753	$ —	$ 19,753
Supplier network	10.0	4,000	(1,467)	2,533
Customer relationships & other intangibles	6.8	42,175	(14,712)	27,463
Developed Technology	10.0	20,460	(1,705)	18,755
Patents	16.5	7,612	(1,143)	6,469
Total intangible assets		$94,000	$ (19,027)	$ 74,973

		December 31, 2017		
(In thousands)	Weighted Average Amortization Period (in years)	Gross Carrying Amount	Accumulated Amortization	Intangible Assets, net
In-process research & development	—	$20,003	$ —	$ 20,003
Supplier network	10.0	4,000	(1,267)	2,733
Customer relationships & other intangibles	6.8	41,345	(11,589)	29,756
Developed Technology	10.0	20,460	(682)	19,778
Patents	16.9	7,389	(1,000)	6,389
Total intangible assets		$93,197	$ (14,538)	$ 78,659

A summary of the net carrying value of goodwill is presented below:

(In thousands)	
December 31, 2016	$105,926
Additions and adjustments	17,907
Foreign exchange	57
December 31, 2017	123,890
Additions and adjustments	—
Foreign exchange	(140)
June 30, 2018	$123,750

GLOBUS MEDICAL, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

NOTE 5. MARKETABLE SECURITIES
The composition of our short-term and long-term marketable securities is as follows:

		June 30, 2018			
(In thousands)	Contractual Maturity (in years)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Short-term:					
Municipal bonds	Less than 1	$83,552	$ 10	$ (50)	$83,512
Corporate debt securities	Less than 1	141,723	13	(218)	141,518
Commercial paper	Less than 1	11,473	1	—	11,474
U.S. government and agency securities	Less than 1	4,479	—	(7)	4,472
Total short-term marketable securities		$241,227	$ 24	$ (275)	$240,976
Long-term:					
Municipal bonds	1-2	$7,146	$ —	$ (6)	$7,140
Corporate debt securities	1-2	72,500	17	(75)	72,442
Asset-backed securities	1-2	76,459	1	(183)	76,277
Total long-term marketable securities		$156,105	$ 18	$ (264)	$155,859

		December 31, 2017			
(In thousands)	Contractual Maturity (in years)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Short-term:					
Municipal bonds	Less than 1	$124,817	$ 1	$ (141)	$124,677
Corporate debt securities	Less than 1	64,599	5	(68)	64,536
Commercial paper	Less than 1	55,768	—	(27)	55,741
U.S. government and agency securities	Less than 1	9,960	—	(24)	9,936
Total short-term marketable securities		$255,144	$ 6	$ (260)	$254,890
Long-term:					
Municipal bonds	1-2	$15,285	$ —	$ (48)	$15,237
Corporate debt securities	1-2	17,155	3	(39)	17,119
Asset-backed securities	1-2	23,841	—	(64)	23,777
Total long-term marketable securities		$56,281	$ 3	$ (151)	$56,133

GLOBUS MEDICAL, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

NOTE 6. FAIR VALUE MEASUREMENTS

Under the accounting for fair value measurements and disclosures, fair value is defined as the price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or the liability in an orderly transaction between market participants on the measurement date. Additionally, a fair value hierarchy was established that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets and liabilities and the lowest priority to unobservable inputs. The level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

Our assets and liabilities measured at fair value on a recurring basis are classified and disclosed in one of the following three categories:

Level 1—quoted prices (unadjusted) in active markets for identical assets and liabilities;

Level 2—observable inputs other than quoted prices in active markets for identical assets and liabilities; and

Level 3—unobservable inputs in which there is little or no market data available, which require the reporting entity to use significant unobservable inputs or valuation techniques.

The fair value of our assets and liabilities measured at fair value on a recurring basis was as follows:

(In thousands)	Balance at June 30, 2018	Level 1	Level 2	Level 3
Assets				
Cash equivalents	$38,236	$ 15	$38,221	$ —
Municipal bonds	90,652	—	90,652	—
Corporate debt securities	213,960	—	213,960	—
Commercial paper	11,474	—	11,474	—
Asset-backed securities	76,277	—	76,277	—
U.S. government and agency securities	4,472	—	4,472	—
Liabilities				
Business acquisition liabilities	10,322	—	—	10,322

18

GLOBUS MEDICAL, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

(In thousands)	Balance at December 31, 2017	Level 1	Level 2	Level 3
Assets				
Cash equivalents	$ 31,549	$5,927	$25,622	$ —
Municipal bonds	139,914	—	139,914	—
Corporate debt securities	81,655	—	81,655	—
Commercial paper	55,741	—	55,741	—
Asset-backed securities	23,777	—	23,777	—
U.S. government and agency securities	9,936	—	9,936	—
Liabilities				
Business acquisition liabilities	15,919	—	—	15,919

Our marketable securities are classified as Level 2 within the fair value hierarchy, as we measure their fair value using market prices for similar instruments and inputs such as actual trade data, benchmark yields, broker/dealer quotes and other similar data obtained from quoted market prices or independent pricing vendors.

Assets and Liabilities That Are Measured at Fair Value on a Nonrecurring Basis

The purchase price of business acquisitions is primarily allocated to the tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values on the acquisition dates, with the excess recorded as goodwill. We utilize Level 3 inputs in the determination of the initial fair value. Non-financial assets such as goodwill, intangible assets, and property, plant, and equipment are subsequently measured at fair value when there is an indicator of impairment and recorded at fair value only when an impairment is recognized. We assess the impairment of intangible assets annually or whenever events or changes in circumstances indicate that the carrying amount of an intangible asset may not be recoverable. The fair value of our goodwill and intangible assets is not estimated if there is no change in events or circumstances that indicate the carrying amount of an intangible asset may not be recoverable.

Business acquisition liabilities represents our contingent milestone, performance and revenue-sharing payment obligations related to our acquisitions and is measured at fair value, based on significant inputs not observable in the market, which represents a Level 3 measurement within the fair value hierarchy. The valuation of business acquisition liabilities uses assumptions we believe would be made by a market participant. We assess these estimates on an ongoing basis as additional data impacting the assumptions is obtained. The balances of the fair value of contingent consideration are recognized within business acquisition liabilities on our condensed consolidated balance sheets, and the changes in the fair value of business acquisition liabilities are recognized within acquisition related costs in the condensed consolidated statements of income.

GLOBUS MEDICAL, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

The recurring Level 3 fair value measurements of our business acquisition liabilities include the following significant unobservable inputs, which have not materially changed since December 31, 2017:

(In thousands)	Fair Value at June 30, 2018	Valuation technique	Unobservable input	Range
			Discount rate	8.5%
Revenue-based payments	$ 5,610	Discounted cash flow	Probability of payment	87.0% - 100.0%
			Projected year of payment	2018 - 2029
			Discount rate	4.4%
Milestone-based payments	$ 4,712	Discounted cash flow	Probability of payment	100.0%
			Projected year of payment	2018

The following table provides a reconciliation of the beginning and ending balances of business acquisition liabilities:

(In thousands)	Three Months Ended		Six Months Ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Beginning balance	$10,854	$15,326	$15,919	$19,849
Purchase price contingent consideration	—	4,871	—	4,871
Changes resulting from foreign currency fluctuations	(204)	42	(63)	42
Contingent payments	(510)	(233)	(5,950)	(5,234)
Changes in fair value of business acquisition liabilities	182	333	416	811
Ending balance	$10,322	$20,339	$10,322	$20,339

NOTE 7. INVENTORIES

(In thousands)	June 30, 2018	December 31, 2017
Raw materials	$18,909	$ 19,984
Work in process	9,203	10,012
Finished goods	86,646	78,413
Total inventories		