

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2019

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 number: **001-38242**

OrthoPediatrics Corp.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

26-1761833

(I.R.S. Employer Identification Number)

**2850 Frontier Drive
Warsaw, IN 46582**

(Address of principal executive offices, including zip code)

(574) 268-6379

(Registrant's telephone number, including area code)

Title of Each Class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, \$0.00025 par value per share	KIDS	The NASDAQ Stock Market LLC

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 No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting, 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

Accelerated filer

Non-accelerated filer

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.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of August 12, 2019, the registrant had 14,939,596 outstanding shares of common stock, \$0.00025 par value per share.

OrthoPediatrics Corp.
Form 10-Q
For the Quarterly Period Ended June 30, 2019

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NOTE REGARDING FORWARD-LOOKING STATEMENTS

All statements, other than statements of historical facts, contained in this quarterly report, including statements regarding our business, operations and financial performance and condition, as well as our plans, objectives and expectations for our business, operations and financial performance and condition, are forward-looking statements. You can often identify forward-looking statements by words such as "anticipate," "believe," "continue," "could," "estimate," "expect," "intend," "may," "might," "target," "ongoing," "plan," "potential," "predict," "project," "should," "will" or "would," or the negative of these terms or other terms. Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our results, activity levels, performance or achievements to be materially different from the information expressed or implied by the forward-looking statements. Forward-looking statements may include, among other things, statements relating to:

- our ability to achieve or sustain profitability in the future;
- our ability to raise additional capital to fund our existing commercial operations, develop and commercialize new products and expand our operations;
- our ability to commercialize our products in development and to develop and commercialize additional products through our research and development efforts, and if we fail to do so we may be unable to compete effectively;
- our ability to generate sufficient revenue from the commercialization of our products to achieve and sustain profitability.
- our ability to comply with extensive government regulation and oversight both in the United States and abroad;
- our ability to maintain and expand our network of third-party independent sales agencies and distributors to market and distribute our products; and
- our ability to protect our intellectual property rights or if we are accused of infringing on the intellectual property rights of others;

We cannot assure you that forward-looking statements will prove to be accurate, and you are encouraged not to place undue reliance on forward-looking statements. Actual results or events could differ materially from the plans, intentions and expectations expressed or implied by the forward-looking statements. You are urged to carefully review and consider the various disclosures made by us in this quarterly report, in our Annual Report on Form 10-K filed with the Securities and Exchange Commission (the "SEC") on March 7, 2019 and in other reports filed with the SEC that discuss the risks and factors that may affect our business. Other than as required by law, we undertake no obligation to update or revise any forward-looking statements to reflect new information, events or circumstances occurring after the date of this quarterly report.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

**ORTHOPEDIATRICS CORP.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)
(In Thousands, Except Share Data)**

	June 30, 2019	December 31, 2018
ASSETS		
Current assets:		
Cash	\$ 21,858	\$ 60,691
Accounts receivable - trade, less allowance for doubtful accounts of \$218 and \$134, respectively	14,974	8,999
Inventories, net	32,855	25,708
Notes receivable	515	502
Prepaid expenses and other current assets	1,277	1,256
Current assets held for sale, net	35,364	—
Total current assets	106,843	97,156
Property and equipment, net	20,915	12,768
Other assets:		
Amortizable intangible assets, net	10,458	1,921
Goodwill	10,971	—
Operating lease right-of-use asset	75	—
Other intangible assets	2,170	260
Total other assets	23,674	2,181
Total assets	\$ 151,432	\$ 112,105
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable - trade	\$ 6,000	\$ 3,971
Accrued compensation and benefits	4,011	3,552
Current portion of long-term debt with affiliate	121	118
Short-term debt with affiliate	30,000	—
Operating lease liabilities	24	—
Current liabilities held for sale	494	—
Other current liabilities	1,537	1,576
Total current liabilities	42,187	9,217
Long-term liabilities:		
Long-term debt with affiliate, net of current portion	21,112	21,156
Operating lease liabilities, net of current portion	51	—
Total long-term liabilities	21,163	21,156
Total liabilities	63,350	30,373
Stockholders' equity:		
Common stock, \$0.00025 par value; 50,000,000 shares authorized; 14,939,462 shares and 14,538,202 shares issued and outstanding as of June 30, 2019 and December 31, 2018, respectively	4	4
Additional paid-in capital	209,262	197,442
Accumulated deficit	(120,729)	(115,091)
Accumulated other comprehensive loss	(455)	(623)
Total stockholders' equity	88,082	81,732
Total liabilities and stockholders' equity	\$ 151,432	\$ 112,105

See notes to condensed consolidated financial statements.

ORTHOPEDIATRICS CORP.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In Thousands, Except Share and Per Share Data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Net revenue	\$ 18,200	\$ 15,077	\$ 32,856	\$ 27,171
Cost of revenue	4,581	3,807	8,582	6,982
Gross profit	13,619	11,270	24,274	20,189
Operating expenses:				
Sales and marketing	7,606	6,776	14,153	12,855
General and administrative	6,569	5,499	12,181	11,516
Research and development	1,234	1,115	2,447	2,333
Total operating expenses	15,409	13,390	28,781	26,704
Operating loss	(1,790)	(2,120)	(4,507)	(6,515)
Other expenses:				
Interest expense, net	632	562	935	1,114
Other expense	37	10	37	63
Total other expenses	669	572	972	1,177
Net loss from continuing operations	\$ (2,459)	\$ (2,692)	\$ (5,479)	\$ (7,692)
Net loss from discontinued operations	\$ (159)	\$ —	\$ (159)	\$ —
Net loss	\$ (2,618)	\$ (2,692)	\$ (5,638)	\$ (7,692)
Net loss attributable to common stockholders	\$ (2,618)	\$ (2,692)	\$ (5,638)	\$ (7,692)
Weighted average common stock - basic and diluted	14,451,979	12,549,226	14,409,752	12,312,814
Net loss per share attributable to common stockholders - basic and diluted	\$ (0.18)	\$ (0.21)	\$ (0.39)	\$ (0.62)

See notes to condensed consolidated financial statements.

ORTHOPEDIATRICS CORP.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(Unaudited)
(In Thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Net loss	\$ (2,618)	\$ (2,692)	\$ (5,638)	\$ (7,692)
Other comprehensive income (loss):				
Foreign currency translation adjustment	(133)	(459)	168	(377)
Other comprehensive income (loss)	(133)	(459)	168	(377)
Comprehensive loss	<u>\$ (2,751)</u>	<u>\$ (3,151)</u>	<u>\$ (5,470)</u>	<u>\$ (8,069)</u>

See notes to condensed consolidated financial statements.

ORTHOPEDIATRICS CORP.
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(Unaudited)
(In Thousands, Except Share Data)

Three and Six Months Ended June 30, 2019

	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
	Shares	Value				
Balance at January 1, 2019	14,538,202	\$ 4	\$ 197,442	\$ (115,091)	\$ (623)	\$ 81,732
Net loss	—	—	—	(3,020)	—	(3,020)
Other comprehensive income	—	—	—	—	301	301
Stock option exercise	18,427	—	565	—	—	565
Restricted stock	125,769	—	471	—	—	471
Balance at March 31, 2019	14,682,398	4	198,478	(118,111)	(322)	80,049
Net Loss	—	—	—	(2,618)	—	(2,618)
Other comprehensive loss	—	—	—	—	(133)	(133)
Acquisition consideration	245,352	—	10,000	—	—	10,000
Stock option exercise	2,983	—	92	—	—	92
Restricted stock	8,729	—	692	—	—	692
Balance at June 30, 2019	14,939,462	\$ 4	\$ 209,262	\$ (120,729)	\$ (455)	\$ 88,082

Three and Six Months Ended June 30, 2018

	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
	Shares	Value				
Balance at January 1, 2018	12,621,781	\$ 2	\$ 150,424	\$ (103,066)	\$ 135	\$ 47,495
Net loss	—	—	—	(5,000)	—	(5,000)
Other comprehensive income	—	—	—	—	82	82
Restricted stock	149,015	—	2,177	—	—	2,177
Balance at March 31, 2018	12,770,796	2	152,601	(108,066)	217	44,754
Net Loss	—	—	—	(2,692)	—	(2,692)
Other comprehensive loss	—	—	—	—	(459)	(459)
Restricted stock	18,243	—	454	—	—	454
Balance at June 30, 2018	12,789,039	\$ 2	\$ 153,055	\$ (110,758)	\$ (242)	\$ 42,057

See notes to condensed consolidated financial statements.

ORTHOPEDIATRICS CORP.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In Thousands)

	Six Months Ended June 30,	
	2019	2018
OPERATING ACTIVITIES		
Net loss	\$ (5,638)	\$ (7,692)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,912	1,400
Stock-based compensation	1,163	2,631
Changes in certain current assets and liabilities:		
Accounts receivable - trade	(5,499)	(4,152)
Inventories	(5,306)	(4,724)
Inventories held by international distributors	167	452
Prepaid expenses and other current assets	(14)	(232)
Accounts payable - trade	1,934	(40)
Accrued expenses and other liabilities	357	1,061
Other	139	(377)
Net cash used in operating activities - continuing operations	(10,785)	(11,673)
Net cash provided by operating activities - discontinued operations	371	—
Net cash used in operating activities	(10,414)	(11,673)
INVESTING ACTIVITIES		
Acquisition of Vilex and Orthex, net of cash acquired	(49,926)	—
Purchases of licenses	(170)	(180)
Purchases of property and equipment	(8,514)	(4,167)
Net cash used in investing activities - continuing operations	(58,610)	(4,347)
Net cash used in investing activities - discontinued operations	(47)	—
Net cash used in investing activities	(58,657)	(4,347)
FINANCING ACTIVITIES		
Payments on mortgage notes	(59)	(56)
Proceeds from issuance of debt with affiliate	30,000	—
Proceeds from exercise of stock options	657	—
Net cash provided by (used in) financing activities	30,598	(56)
NET DECREASE IN CASH	(38,473)	(16,076)
Cash, beginning of year	60,691	42,582
Cash, end of period	22,218	26,506
Less cash of discontinued operations, end of period	360	—
Cash of continuing operations, end of period	\$ 21,858	\$ 26,506
SUPPLEMENTAL DISCLOSURES		
Cash paid for interest	\$ 935	\$ 1,114
Transfer of instruments from property and equipment to inventory	\$ 267	\$ 594
Acquisition consideration of common shares	\$ 10,000	\$ —

See notes to condensed consolidated financial statements.

ORTHOPEDIATRICS CORP.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(Dollars In Thousands, Except Share and Per Share data)

NOTE 1 – BUSINESS

OrthoPediatics Corp., a Delaware corporation, is a medical device company committed to designing, developing and marketing anatomically appropriate implants and devices for children with orthopedic conditions, giving pediatric orthopedic surgeons and caregivers the ability to treat children with technologies specifically designed to meet their needs. We sell our specialized products, including PediLoc[®], PediPlates[®], Cannulated Screws, PediFlex[™] nail, PediNail[™], PediLoc[®] Tibia, ACL Reconstruction System, Locking Cannulated Blade, Locking Proximal Femur, Spica Tables, RESPONSE Spine, BandLoc, Pediguard and Pediatric Nailing Platform | Femur, to various hospitals and medical facilities throughout the United States and various international markets. We currently use a contract manufacturing model for the manufacturing of implants and related surgical instrumentation.

In 2017, we expanded operations and established legal entities in the United Kingdom, Australia and New Zealand permitting us to sell under an agency model direct to local hospitals in these countries. In September 2018, we further expanded operations in Canada selling direct to local hospitals, and in January 2019 we expanded to Belgium and the Netherlands. Additionally, in March 2019 we established a holding company and an operating company in the Netherlands that are expected to enhance our operations in Europe.

On June 4, 2019, we purchased all the issued and outstanding shares of stock of Vilex in Tennessee, Inc. ("Vilex") and all the issued and outstanding units of membership interests in Orthex, LLC ("Orthex") for \$60,000 in total consideration. Vilex and Orthex are primarily manufacturers of foot and ankle surgical implants, including cannulated screws, fusion devices, surgical staples and bone plates, as well as Orthex Hexapod technology which is used to treat pediatrics congenital deformities and limb length discrepancies. Because the current products of Vilex also include adult offerings that are not core to the Company's pediatrics business, the Company has begun taking steps to divest the non-core Vilex assets. The Company anticipates completing the divestiture by the end of 2019.

Our largest investor is Squadron Capital LLC ("Squadron"), a family office firm headquartered near Hartford, Connecticut.

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying condensed consolidated financial statements include the accounts of OrthoPediatics Corp. and its wholly-owned subsidiaries, OrthoPediatics US Distribution Corp., OrthoPediatics EU Limited, OrthoPediatics AUS PTY LTD, OrthoPediatics NZ Limited, OP EU B.V., and OP Netherlands B.V., Vilex in Tennessee, Inc., and Orthex, LLC (collectively, the "Company," "we," "our" or "us"). All intercompany balances and transactions have been eliminated.

Unaudited Interim Condensed Consolidated Financial Statements

We have prepared the accompanying condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP"). The accompanying condensed consolidated balance sheets as of June 30, 2019 and December 31, 2018, the condensed consolidated statements of operations for the three and six months ended June 30, 2019 and 2018, the condensed consolidated statements of comprehensive loss for the three and six months ended June 30, 2019 and 2018, the condensed consolidated statements of stockholders' equity for the three and six

months ended June 30, 2019 and 2018 and the condensed consolidated statements of cash flows for the six months ended June 30, 2019 and 2018 are unaudited and should be read in conjunction with the annual consolidated financial statements as of and for the year ended December 31, 2018 and related notes thereto contained in our Annual Report on Form 10-K filed with the Securities and Exchange Commission ("SEC") on March 7, 2019. The financial data and other financial information disclosed in the notes to the accompanying condensed consolidated financial statements are also unaudited. As such, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to applicable rules and regulations thereunder.

The unaudited condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements as of and for the year ended December 31, 2018 and, in management's opinion, include all adjustments, consisting of only normal recurring adjustments, necessary for the fair presentation of the financial statements for the interim periods. The results of operations for the three and six months ended June 30, 2019 are not necessarily indicative of the results to be expected for the full fiscal year or for any other period.

The accompanying condensed consolidated financial statements have been prepared assuming our Company will continue as a going concern. We have experienced recurring losses from operations since our inception and had an accumulated deficit of \$120,729 and \$115,091 as of June 30, 2019 and December 31, 2018, respectively. In conjunction with the acquisition of Vilex and Orthex, the Company entered into a new \$30,000 short-term loan facility with Squadron in addition to the existing \$20,000 term loan facility and \$15,000 revolving credit facility previously established. The new term loan is due upon the earliest of: (i) the date on which any persons acquire (x) capital stock of the Company possessing the voting power to elect a majority of the Company's Board of Directors (whether by merger, consolidation, reorganization, combination, sale or transfer), or (y) all or substantially all of the Company's assets, determined on a consolidated basis; (ii) the date on which the Company sells its equity interest in, or all or substantially all of the assets of, Vilex; and (iii) May 31, 2020. The maturity date for the remaining Squadron debt is January 31, 2023. Management continues to monitor cash flows and liquidity on a regular basis. We believe that our cash balance at June 30, 2019, expected cash flows from operations for the next twelve months subsequent to the issuance of the condensed consolidated financial statements, and the likelihood that the Vilex assets held for sale will be sold prior to the maturity of the new term loan are sufficient to enable us to maintain current and essential planned operations for more than the next twelve months. If the Vilex assets are not sold prior to the maturity of the new term loan, we will work to extend the maturity date or obtain external funding in order to repay the loan.

Use of Estimates

Preparation of the condensed consolidated financial statements requires the use of estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, as of the date of the condensed consolidated financial statements. By their nature, these judgments are subject to an inherent degree of uncertainty. We use historical experience and other assumptions as the basis for our judgments and estimates. Because future events and their effects cannot be determined with precision, actual results could differ significantly from these estimates. Any changes in these estimates will be reflected in the condensed consolidated financial statements.

Foreign Currency Transactions

We currently bill our international distributors in United States ("U.S.") dollars, resulting in minimal foreign exchange transaction expense.

Beginning in the second quarter of 2017, we began selling direct within the United Kingdom, Ireland, Australia and New Zealand and billing using the local currency for each country. In September 2018, we began selling direct in Canada and in January 2019 in Belgium and the Netherlands. The financial

statements of our foreign subsidiaries are accounted for and have been translated into U.S. dollars using end-of-period exchange rates for assets and liabilities and average exchange rates during each reporting period for results of operations. Foreign currency translation adjustments have been recorded as a separate component of the condensed consolidated statements of comprehensive loss.

Revenue from Contracts with Customers

In accordance with ASC 606, "*Revenue From Contracts With Customers (ASC 606)*", revenue is recognized when a customer obtains control of promised goods or services. The amount of revenue recognized reflects the consideration to which the Company expects to be entitled to receive in exchange for these goods or services, and excludes any sales incentives or taxes collected from a customer which are subsequently remitted to government authorities.

Revenue Recognition – United States

Revenue in the United States is generated primarily from the sale of our implants and, to a much lesser extent, from the sale of our instruments. Sales in the United States are primarily to hospital accounts through independent sales agencies. We recognize revenue when our performance obligations under the terms of a contract with our customer are satisfied. This typically occurs when we transfer control of our products to the customer, generally upon implantation or when title passes upon shipment. The products are generally consigned to our independent sales agencies, and revenue is recognized when the products are used by or shipped to the hospital for surgeries on a case by case basis. On rare occasions, hospitals purchase products for their own inventory, and revenue is recognized when the hospital obtains control of the product, typically either upon shipment or delivery of the product dependent on the terms of the contract. Pricing for each customer is dictated by a unique pricing agreement, which does not generally include rebates or discounts.

Revenue Recognition – International

Outside of the United States, we primarily sell our products through independent stocking distributors. Generally, the distributors are allowed to return products, and some are thinly capitalized. Based on our history of collections and returns from international customers, we previously concluded that collectibility was not reasonably assured at the time of delivery for certain customers who had not evidenced a consistent pattern of timely payment. Accordingly, in the past we did not recognize international revenue and associated cost of revenue at the time title transfers for these customers for whom collectibility had not been deemed probable based on the customer's history and ability to pay, but rather when cash had been received. Until such payment, cost of revenue was recorded as inventories held by international distributors, net of adjustment for estimated unreturnable inventory, on our condensed consolidated balance sheets.

Following a review of our collection history, we deemed collectibility was probable for all international stocking distributors effective January 1, 2019. Based on a history of reliable collections, we have concluded that a contract exists and revenue should be recognized when we transfer control of our products to the customer, generally upon implantation or when title passes upon shipment.

In early 2017, we expanded operations and established legal entities in the United Kingdom, Australia and New Zealand permitting us to sell under an agency model direct to local hospitals in these countries. Additionally, in September 2018 we began selling in Canada and in January 2019 to Belgium and the Netherlands utilizing the agency model. The products are generally consigned to our independent sales agencies, and revenue is recognized when the products are used by or shipped to the hospital for surgeries on a case by case basis. On rare occasions, hospitals purchase products for their own inventory, and revenue is recognized when the hospital obtains control of the product, typically either upon shipment or delivery of the product dependent on the terms of the contract. Pricing for each

customer is dictated by a unique pricing agreement, which does not generally include rebates or discounts.

Cash and Cash Equivalents

We maintain cash in bank deposit accounts which, at times, may exceed federally insured limits. To date, we have not experienced any loss in such accounts. We consider all highly liquid investments with original maturity of three months or less at inception to be cash equivalents. The carrying amounts reported in the balance sheet for cash are valued at cost, which approximates fair value.

Accounts Receivable

Accounts receivable are uncollateralized customer obligations due under normal trade terms, generally requiring payment within 30 days from the invoice date. Account balances with invoices over 30 days past due are considered delinquent. No interest is charged on past due accounts. Payments of accounts receivable are applied to the specific invoices identified on the customer's remittance advice or, if unspecified, to the customer's account as an unapplied credit.

The carrying amount of accounts receivable is reduced by an allowance that reflects management's best estimate of the amounts that will not be collected, determined principally on the basis of historical experience, management's assessment of the collectability of specific customer accounts and the aging of the accounts receivable. All accounts or portions thereof deemed to be uncollectible or to require an excessive collection cost are written off to the allowance for doubtful accounts.

Inventories, net

Inventories are stated at the lower of cost or net realizable value, with cost determined using the first-in-first-out method. Inventories, which consist of implants and instruments held in our warehouse or with third-party independent sales agencies or distributors, are considered finished goods and are purchased from third parties.

We evaluate the carrying value of our inventories in relation to the estimated forecast of product demand, which takes into consideration the life cycle of the product. A significant decrease in demand could result in an increase in the amount of excess inventory on hand, which could lead to additional charges for excess and obsolete inventory.

The need to maintain substantial levels of inventory impacts our estimates for excess and obsolete inventory. Each of our implant systems are designed to include implantable products that come in different sizes and shapes to accommodate the surgeon's needs. Typically, a small number of the set components are used in each surgical procedure. Certain components within each set may become obsolete before other components based on the usage patterns. We adjust inventory values, as needed, to reflect these usage patterns and life cycle.

In addition, we continue to introduce new products, which may require us to take additional charges for excess and obsolete inventory in the future.

Property and Equipment, net

Property and equipment are carried at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful life of the assets. When assets are retired or otherwise disposed of, costs and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recognized in operations for the period. Maintenance and repairs that prolong or extend the useful life are capitalized, whereas standard maintenance, replacements, and repair costs are expensed as incurred.

Instruments are hand-held devices, specifically designed for use with our implants and are used by surgeons during surgery. Instruments deployed within the United States, United Kingdom, Australia, New Zealand, Canada, Belgium and the Netherlands are carried at cost less accumulated depreciation and are recorded in property and equipment, net on the condensed consolidated balance sheets.

Sample inventory consists of our implants and instruments, and is maintained to market and promote our products. Sample inventory is carried at cost less accumulated depreciation.

Depreciable lives are generally as follows:

Building and building improvements	25 to 30 years
Furniture and fixtures	5 to 7 years
Computer equipment	3 to 5 years
Business software	3 years
Office and other equipment	5 to 7 years
Instruments	5 years
Sample inventory	2 years

Amortizable Intangible Assets, net

Amortizable intangible assets include fees necessary to secure various patents and licenses, and the value of internally developed software, customer relationships and non-competition agreements related to the acquisition of Orthex. Vilex has amortizable intangible assets including patents, customer relationships and non-competition agreements which are included in current assets held for sale, net on the condensed consolidated balance sheet as of June 30, 2019. Amortization is calculated on a straight-line basis over the estimated useful life of the asset. Amortization for patents and licenses commences at the time of patent approval and market launch, respectively. Amortization for the Orthex and Vilex assets commenced upon acquisition. Intangible assets are amortized over a 3 to 20 year period.

Amortizable intangible assets are assessed for impairment annually or whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. Recoverability is measured by a comparison of the carrying amount to future net undiscounted cash flows expected to be generated by the associated asset. If such assets are determined to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount exceeds the fair market value of the assets. No impairment charges were recorded in any of the periods presented.

Goodwill and Other Intangible Assets

Our goodwill represents the excess of the cost over the fair value of net assets acquired. The determination of the value of goodwill and intangible assets arising from acquisitions requires extensive use of accounting estimates and judgments to allocate the purchase price to the fair value of net tangible and intangible assets acquired. Goodwill is not amortized and is assessed for impairment using fair value measurement techniques on an annual basis or more frequently if facts and circumstances warrant such a review. The goodwill is considered to be impaired if we determine that the carrying value of the reporting unit exceeds its respective fair value.

We have indefinite lived tradename assets that are reviewed for impairment by performing a quantitative analysis, which occurs annually in the fourth quarter or whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. Recoverability is measured by a comparison of the carrying amount to future net undiscounted cash flows expected to be generated by the associated asset. If such assets are determined to be impaired, the impairment to be recognized is

measured by the amount by which the carrying amount exceeds the fair market value of the assets. No impairment charges were recorded in any of the periods presented.

Cost of Revenue

Cost of revenue consists primarily of products purchased from third-party suppliers, excess and obsolete inventory adjustments, inbound freight, and royalties. Our implants and instruments are manufactured to our specifications by third-party suppliers who meet our manufacturer qualifications standards. Our third-party manufacturers are required to meet the standards of the Food and Drug Administration (the "FDA"), and the International Organization for Standardization, as well as other country-specific quality standards. The majority of our implants and instruments are produced in the United States.

Sales and Marketing Expenses

Sales and marketing expenses primarily consist of commissions to our domestic and select international independent sales agencies and consignment distributors, as well as compensation, commissions, benefits and other related costs for personnel we employ. Commissions and bonuses are generally based on a percentage of sales. Our international independent stocking distributors purchase instrument sets and replenishment stock for resale, and we do not pay commissions or any other sales related costs for international sales to distributors.

Advertising Costs

Advertising costs consist primarily of print advertising, trade shows, and other related expenses. Advertising costs are expensed as incurred and are recorded as a component of sales and marketing expense.

Research and Development Costs

Research and development costs are expensed as incurred. Our research and development expenses primarily consist of costs associated with engineering, product development, consulting services, outside prototyping services, outside research activities, materials, development and protection of our intellectual property portfolio, as well as other costs associated with development of our products. Research and development costs also include related personnel and consultants' compensation expense.

Research and development costs were \$1,234 and \$1,115 for the three months ended June 30, 2019 and 2018, respectively, and \$2,447 and \$2,333 for the six months ended June 30, 2019 and 2018, respectively.

Stock-Based Compensation

Prior to our Initial Public Offering ("IPO") in October 2017, we maintained an Amended and Restated 2007 Equity Incentive Plan (the "2007 Plan") that provided for grants of options and restricted stock to employees, directors and associated third-party representatives of the Company as determined by the Board of Directors. The 2007 Plan had authorized 1,585,000 shares for award.

Immediately prior to our IPO, we adopted our 2017 Incentive Award Plan (the "2017 Plan") which replaced the 2007 Plan. The 2017 Plan provides for grants of options and restricted stock to officers, employees, consultants or directors of our Company. The 2017 Plan has authorized 1,789,647 shares for award.

Options holders, upon vesting, may purchase common stock at the exercise price, which is the estimated fair value of our common stock on the date of grant. Option grants generally vest immediately or over three years. No stock options were granted in any of the periods presented.

Restricted stock may not be transferred prior to the expiration of the restricted period, which is typically three years. The restricted stock that had been granted under the 2007 Plan had restriction periods that generally lasted until the earlier of six years from the date of grant, or an IPO or change in control, as defined in the 2007 Plan. All restricted stock granted prior to May 2014 vested upon our IPO and the remaining grants under the 2007 Plan vested six months after the IPO. We recognize the reversal of stock compensation expense when a restricted stock forfeiture occurs as opposed to estimating future forfeitures.

We estimate the fair value of stock options and restricted stock at the grant date. Stock-based compensation is recognized ratably over the requisite service period, which is generally the vesting period for stock options and the restriction period for restricted stock.

Calculating the fair value of stock-based awards requires that we make highly subjective assumptions. We use the Black-Scholes option pricing model to value our stock options. Use of the valuation methodology requires that we make assumptions as to the volatility of our common stock, the expected term of our stock options and the risk free rate of return for a period that approximates the expected term of our stock options. Because we were a privately-held company with a limited operating history, we utilized the historical stock price volatility from a representative group of comparable industry competitors to estimate expected stock price volatility.

Prior to our IPO, for restricted stock awards we applied a discount for lack of marketability to the fair value of common stock to estimate the impact of valuing a minority interest in our Company as a closely held, non-public company with no liquid market for its shares. Following the IPO, we value restricted stock awards using the market value on the grant date.

Comprehensive Income (Loss)

Comprehensive income (loss) is defined as the change in equity during a period from transactions and other events and circumstances from non-owner sources. Comprehensive income (loss) includes foreign currency translation adjustments.

Income Taxes

We account for income taxes under the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the condensed consolidated financial statements. Under this method, we determine deferred tax assets and liabilities on the basis of the differences between the financial statement and tax bases of assets and liabilities by using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date.

We recognize deferred tax assets to the extent that we believe that these assets are more likely than not to be realized. In making such a determination, we consider all available positive and negative evidence. If we determine that we would be able to realize our deferred tax assets in the future in excess of their net recorded amount, we would make an adjustment to the valuation allowance.

We record uncertain tax positions on the bases of a two-step process in which (i) we determine whether it is more likely than not that the tax positions will be sustained on the basis of the technical merits of the positions and (ii) for those tax positions that meet the more-likely-than-not recognition threshold, we recognize the largest amount of tax benefit that is more than 50% likely to be realized upon ultimate settlement with the related tax authority.

“Emerging Growth Company” and “Smaller Reporting Company” Reporting Requirements

We qualify as an “emerging growth company” as defined in the Jumpstart Our Business Startups Act (the “JOBS Act”). For as long as a company is deemed to be an emerging growth company, it may take advantage of specified reduced reporting and other regulatory requirements that are generally unavailable to other public companies. Among other things, we are not required to provide an auditor attestation report on the assessment of the internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act of 2002 and our disclosure obligations regarding executive compensation may be reduced. We may take advantage of these provisions until the last day of our fiscal year following the fifth anniversary of our initial public offering, or December 31, 2022. However, if certain events occur prior to the end of such five-year period, including if we become a “large accelerated filer,” our annual gross revenue exceeds \$1.07 billion or we issue more than \$1.0 billion of non-convertible debt in any three-year period, we will cease to be an emerging growth company prior to the end of such five-year period.

Section 107 of the JOBS Act also provides that an emerging growth company can delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. We have irrevocably elected not to avail ourselves of this exemption from new or revised accounting standards and, therefore, we are subject to the same new or revised accounting standards as other public companies that are not emerging growth companies.

We are also a “smaller reporting company,” as such term is defined in Rule 12b-2 under the Securities Exchange Act of 1934, as amended. As a result, many of the same exemptions from reporting requirements available to us as an emerging growth company are also available to us as a smaller reporting company, including not being required to comply with the auditor attestation requirements of Section 404(b) of the Sarbanes-Oxley Act and reduced disclosure obligations regarding executive compensation. To the extent that we continue to qualify as a smaller reporting company, after we cease to qualify as an emerging growth company, those exemptions may continue to be available to us.

Recent Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02 “Leases,” which increases transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The Company adopted this standard on January 1, 2019.

The new standard requires lessees to recognize both the right-of-use assets and lease liabilities in the balance sheet for most leases, whereas under previous GAAP only finance lease liabilities (previously referred to as capital leases) were recognized in the balance sheet. In addition, the definition of a lease has been revised which may result in changes to the classification of an arrangement as a lease. Under the new standard, an arrangement that conveys the right to control the use of an identified asset by obtaining substantially all of its economic benefits and directing how it is used is a lease, whereas the previous definition focuses on the ability to control the use of the asset or to obtain its output. Quantitative and qualitative disclosures related to the amount, timing and judgments of an entity's accounting for leases and the related cash flows are expanded. Disclosure requirements apply to both lessees and lessors, whereas, previous disclosures related only to lessees. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee have not significantly changed from previous GAAP. Lessor accounting is also largely unchanged.

The new standard provides a number of transition practical expedients, which the Company has elected, including:

- a “package of three” expedients that must be taken together and allow entities to (1) not reassess whether existing contracts contain leases, (2) carryforward the existing lease classification, and (3) not reassess initial direct costs associated with existing leases, and

- an implementation expedient which allows the requirements of the standard in the period of adoption with no restatement of prior periods.

The Company has assessed the lease standard and executed a detailed implementation plan, which included the following key activities:

- Developed a complete lease inventory and abstracted the required data attributes as applicable in a manner that supports the Company's lease portfolio.
- Evaluated the transition practical expedients available under the standard.
- Identified, assessed and documented technical accounting issues, policy considerations and financial reporting implications.
- Identified and implemented changes to processes and controls to ensure all impacts of the new standard are effectively addressed.

The adoption of the new standard did not result in a material right of use asset or lease obligation for operating leases recorded in the Company's condensed consolidated balance sheets on January 1, 2019, primarily due to the lack of existing lease contracts, or other contracts that meet the standard for consideration as a lease under the definitions discussed above. The Company has limited operating leases for office equipment maintained at its headquarters, and has not historically leased any real estate or office space.

In conjunction with the Company's acquisition of Vilex and Orthex on June 4, 2019, the Company acquired two leased facilities in Tennessee and Florida. The Company analyzed each lease agreement and recorded a right-of-use asset and liability of \$77 for Orthex and \$246 for Vilex, respectively, on its condensed consolidated balance sheet as of the acquisition date. As of June 30, 2019, the Company's right-of-use asset and liabilities were \$75 and \$75, respectively, associated with Orthex. The Vilex operating leases were recorded in current assets held for sale, net and current liabilities held for sale as of June 30, 2019.

NOTE 3 –BUSINESS COMBINATION

On June 4, 2019, the Company purchased all the issued and outstanding shares of stock of Vilex and units of membership interests in Orthex for \$50,000 in cash, adjusted for working capital, and 245,352 shares of common stock, \$0.00025 par value per share, of the Company. The shares of common stock were valued at \$40.76 per share, the volume weighted average trading price during the thirty day trading period ending on May 30, 2019. In addition, \$3,000 was placed in an escrow account for a period of up to twenty months to cover certain indemnification obligations and to secure certain closing adjustments. The Company incurred \$589 of acquisition-related costs that are included in general and administrative expenses on the condensed consolidated statement of operations. The purchase price allocation set forth herein is preliminary and may be revised as we finalize the fair value determination for certain assets acquired, and determine any further working capital adjustments. Any revisions or changes identified during the measurement period, which could be up to 12 months from the closing date of the acquisition, may be material.

The following table summarizes the total consideration paid for Vilex and Orthex and the preliminary allocation of purchase price to the estimated fair value of the assets acquired and liabilities assumed at the acquisition date (in thousands):

Description	Amount
Preliminary fair value of estimated total acquisition consideration	\$ 60,276
Assets	
Cash and cash equivalents	348
Trade receivables	1,849
Inventory	3,905
Prepaid expenses and other current assets	12
Property and equipment	7,541
Intangible assets	18,260
Operating lease right-of-use asset	323
Total assets	32,238
Liabilities	
Accounts payable and accrued liabilities	564
Operating lease liabilities	323
Other long-term liabilities	68
Total liabilities	955
Less: total net assets	31,283
Goodwill	\$ 28,993

The fair value of identifiable intangible assets were based on valuations using a combination of the income and cost approach. The estimated fair value and useful life of identifiable intangible assets are as follows:

	Amount	Remaining Economic Useful Life
Trademarks / Names	\$ 4,160	Indefinite
Patents	8,380	15 years
Internally Developed Software	960	10 years
Customer Relationships	4,690	12 years
Non-competition Agreements	70	5 years
	<u>\$ 18,260</u>	

NOTE 4 - DISCONTINUED OPERATIONS

On June 4, 2019, the Company acquired Vilex, a manufacturer of foot and ankle surgical implants. Since the Vilex products include adult offerings that are not core to the Company's pediatric business, the Company received Board approval to take the steps necessary to divest the non-core Vilex assets. As a result, certain assets and liabilities of Vilex are classified as held for sale on the condensed consolidated balance sheet as of June 30, 2019.

The following summarized financial information has been segregated from continuing operations and reported as discontinued operations for the three and six months ended June 30, 2019:

	Three and Six Months Ended	
	June 30, 2019	
Revenue	\$	414
Operating expenses		507
Depreciation and amortization		66
Operating loss		(159)
Loss from discontinued operations	\$	(159)

The assets and liabilities held for sale on the condensed consolidated balance sheet as of June 30, 2019 are as follows:

	June 30, 2019	
Assets:		
Cash	\$	360
Accounts receivable		850
Inventories		2,163
Prepaid expenses and other current assets		12
Property and equipment		6,015
Amortizable intangible assets		5,452
Goodwill		18,022
Operating lease right-of-use asset		240
Other intangible assets		2,250
Current assets held for sale, net		35,364
Liabilities:		
Accounts payable		71
Accrued compensation and benefits		159
Operating lease liabilities		239
Other current liabilities		25
Liabilities held for sale	\$	494

NOTE 5 - DEBT AND CREDIT ARRANGEMENTS

Long-term debt consisted of the following:

	June 30, 2019		December 31, 2018	
Note payable to Squadron	\$	19,874	\$	19,856
Short-term debt with affiliate		30,000		—
Mortgage payable to affiliate		1,359		1,418
Total debt		51,233		21,274
Less: current maturities		30,121		118
Long-term debt with affiliate, net of current maturities	\$	21,112	\$	21,156

In April 2017, we entered into the Third Amended and Restated Loan and Security Agreement with Squadron providing us with (i) a term loan in the amount of \$18,400, bearing interest at a per annum rate of 10%, and (ii) a term loan in the amount of \$16,000, bearing interest at a per annum rate of 11%. Each of the term loans was to have matured on March 31, 2019. In addition, the agreement provided for a \$1,000 extension fee payable in three annual installments. The extension fee was recorded in full upon closing as a deferred financing cost within long-term debt with affiliate, net of current portion, and was to be recognized ratably over the term of the agreement as deferred financing charges within interest expense on the consolidated statements of operations assuming an IPO did not happen.

Effective December 31, 2017, we entered into a Fourth Amended and Restated Loan and Security Agreement, or the Loan Agreement, with Squadron. Pursuant to the Loan Agreement, a majority of the term loan amounts under the previous agreement with Squadron were consolidated into a \$20,000 term note, or the Term Note A, and a \$15,000 revolving credit facility was established. Also, \$667 of the extension fee was canceled as of the completion of our IPO in October 2017. Both facilities include interest only payments and have interest rates equal to the greater of (a) three month LIBOR plus 8.61% and (b) 10%. The Loan Agreement also extended the maturity date to January 31, 2023.

In order to finance a portion of the cash consideration for the acquisition of Vilex and Orthex, the Company entered into a first Amendment, or the Amendment, to the Loan Agreement (as so amended, the "Amended Loan Agreement"), with Squadron. The Amended Loan Agreement provides for a new \$30,000 term loan facility, represented by a Term Note B, in addition to the existing \$20,000 Term Note A and \$15,000 revolving credit facility. Similar to the other facilities under the Amended Loan Agreement, the Term Note B is subject to interest only payments at an interest rate equal to the greater of (a) three month LIBOR plus 8.61%, and (b) 10.00%. The maturity date for the Term Note B is the earliest of: (i) the date on which any persons acquire (x) capital stock of the Company possessing the voting power to elect a majority of the Company's Board of Directors (whether by merger, consolidation, reorganization, combination, sale or transfer), or (y) all or substantially all of the Company's assets, determined on a consolidated basis; (ii) the date on which the Company sells its equity interest in, or all or substantially all of the assets of, Vilex; and (iii) May 31, 2020. Until such time that the Term Note B and all accrued interest thereon has been paid in full, no borrowings under the revolving loan facility are permitted.

As provided in the Amendment, Orthex has become a "Borrower" under the Amended Loan Agreement and, as such, granted to Squadron a security interest in all of its personal property as collateral for all borrowings under the Amended Loan Agreement. In connection with the Amendment, the Company granted a security interest in (a) the units of membership interest in Orthex held by the Company, and (b) the shares of stock of Vilex held by the Company, as collateral for borrowings under the Amended Loan Agreement. Borrowings under the Amended Loan Agreement are secured by substantially all of the Company's assets and are unconditionally guaranteed by each of its subsidiaries with the exception of Vilex.

The fair value of our notes payable to Squadron were estimated based on prices for the same or similar issues and the current interest rates offered for the debt of the same remaining maturities, which are considered level 2 inputs in accordance with ASC Topic 820, "*Fair Value Measurements and Disclosures*." At June 30, 2019, the fair value approximated the carrying value.

In connection with the purchase of our office and warehouse space in Warsaw, Indiana in August 2013, we entered into a mortgage note payable to Tawani Enterprises Inc., an affiliate of Squadron. Pursuant to the terms of the mortgage note, we pay Tawani Enterprises Inc. monthly principal and interest installments of \$16 with interest compounded at 5% until maturity in 2028, at which time a final payment of remaining principal and interest is due. The mortgage is secured by the related real estate and building. At December 31, 2018, the mortgage balance was \$1,418 of which current principal due of \$118 was included in current portion of long-term debt. At June 30, 2019, the mortgage balance was \$1,359 of which current principal due of \$121 was included in current portion of long-term debt.

Interest expense relating to notes payable to Squadron and Tawani was \$632 and \$562 for the three months ended June 30, 2019 and 2018, respectively, and \$935 and \$1,114 for the six months ended June 30, 2019 and 2018, respectively.

NOTE 6 - STRATEGIC ARRANGEMENTS

Effective December 1, 2007, we entered into a ten-year agreement with Case Western Reserve University ("CASE") to assist in certain aspects of our research and development. Effective August 2, 2017, we entered into an Amended and Restated License Agreement to account for additional licensed product and extend the agreement for another ten years. The main focus of this research and development involves leveraging our exclusive rights to the Hamann-Todd Collection of the Cleveland National History Museum, the world's largest pediatric osteological collection, to assist in the design of implants which match pediatric bone curvature and structure.

In exchange for services, CASE receives certain royalties and up-front fees. The royalties and certain fees are contingent upon our obtaining FDA approval and the launch of our products into the marketplace. CASE receives a minimum annual royalty of \$10 or a royalty of 3% of net sales on products, whichever is greater. Additionally, for each new product developed, CASE will receive milestone payments of \$5 for FDA approval to sell our products within the United States and \$10 for general product launch. Additionally, CASE receives a royalty of 3% of net sales on products fully developed and being sold in the marketplace.

The royalty expense recognized related to the CASE agreement is recorded as a component of cost of revenue and was \$37 and \$37 for the three months ended June 30, 2019 and 2018, respectively, and \$74 and \$72 for the six months ended June 30, 2019 and 2018, respectively. At June 30, 2019 and December 31, 2018, \$37 and \$36, respectively, was due to CASE.

NOTE 7 - INCOME TAXES

For the three and six month periods ended June 30, 2019 and 2018, we calculated the provision of income taxes by applying an estimate of the annual effective tax rate for the full fiscal year to the ordinary loss for the reporting period resulting in a zero tax provision consistent with prior periods.

The deferred tax assets were fully offset by a valuation allowance at June 30, 2019 and December 31, 2018, and no income tax benefit has been recognized in our condensed consolidated statements of operations for any of the periods presented. At December 31, 2018, we had available federal and state tax loss carryforwards of \$87,345 and tax credits for federal and state tax purposes of \$335 which begin to expire in 2028. Any losses incurred in 2018 and beyond do not expire. An ownership change under Section 382 of the Internal Revenue Code was deemed to occur on May 30, 2014. Given the limitation calculation, we anticipate approximately \$16,200 in losses generated prior to the ownership change date will be subject to potential limitation. The estimated annual limitation is \$1,062, which is increased by \$2,302 over the first five years as a result of an unrealized built in gain. A second ownership change under Section 382 was deemed to occur on December 11, 2018. The estimated annual limitation is \$9,736, which is increased by \$22,430 over the first five years as a result of an unrealized built in gain.

Management assesses the available positive and negative evidence to estimate whether sufficient future taxable income will be generated to permit use of the existing deferred tax assets. A significant piece of objective negative evidence evaluated was the cumulative loss incurred over the three-year period ended December 31, 2018 and through June 30, 2019. Such objective evidence limits the ability to consider other subjective evidence, such as our projections for future growth.

NOTE 8 - STOCKHOLDERS' EQUITY

Stock Options

The fair value for options granted at the time of issuance were estimated at the date of grant using a Black-Scholes options pricing model. Significant assumptions included in the option value model include the fair value of our common stock at the grant date, weighted average volatility, risk-free interest rate, dividend yield and the forfeiture rate. There were no stock options granted in any of the periods presented.

Our stock option activity and related information are summarized as follows:

	Options	Weighted-Average Exercise Price	Contractual Terms (in Years)
Outstanding at January 1, 2019	112,094	\$ 30.32	1.8
Exercised	(21,409)	30.69	
Outstanding at June 30, 2019	<u>90,685</u>	\$ 30.23	1.4

Options generally include a time-based vesting schedule permitting the options to vest ratably over three years. At June 30, 2019 and December 31, 2018, all options were fully vested.

There was no stock-based compensation expense on stock options for the three and six month periods ended June 30, 2019 and 2018, respectively.

Restricted Stock

Our restricted stock activity and related information are summarized as follows:

	Restricted Stock	Weighted-Average Remaining Contractual Terms (in Years)
Outstanding at January 1, 2019	177,293	2.2
Granted	139,619	
Forfeited	(5,121)	
Vested	(4,444)	
Outstanding at June 30, 2019	<u>307,347</u>	2.1
Restricted stock exercisable at June 30, 2019	—	

At June 30, 2019, there was \$6,999 of unrecognized compensation expense remaining related to our service-based restricted stock awards. The unrecognized compensation cost was expected to be recognized over a weighted-average period of 2.1 years or earlier upon an elimination of the restriction period as a result of a change in control event.

Stock-based compensation expense on restricted stock amounted to \$692 and \$454 for the three months ended June 30, 2019 and 2018, respectively, and \$1,163 and \$2,631 for the six months ended June 30, 2019 and 2018, respectively.

Warrants

Our warrant activity and related information are summarized as follows:

	Warrants	Weighted-Average Exercise Price
Outstanding at January 1, 2019	6,790	\$ 27.81
Forfeited or expired	(1,811)	—
Outstanding at June 30, 2019	<u>4,979</u>	<u>\$ 27.88</u>

For all periods presented, the warrants were issued at exercise prices ranging from \$26.27 to \$30.97 per share. The warrants generally have a ten-year term. At June 30, 2019, no warrants had been exercised. At inception, no fair value was assigned to the warrants.

NOTE 9 – NET LOSS PER SHARE

The following is a reconciliation of basic and diluted net loss per share attributable to common stockholders:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Net loss attributable to common stockholders - basic and diluted	\$ (2,618)	\$ (2,692)	\$ (5,638)	\$ (7,692)
Weighted average number of shares - basic and diluted	14,451,979	12,549,226	14,409,752	12,312,814
Net loss per share attributable to common stockholders - basic and diluted ⁽¹⁾	<u>\$ (0.18)</u>	<u>\$ (0.21)</u>	<u>\$ (0.39)</u>	<u>\$ (0.62)</u>

⁽¹⁾ The effect of discontinued operations on loss per share has been excluded for 2019 as it is not material.

Our basic and diluted net loss per share is computed using the two-class method. The two-class method is an earnings allocation that determines net income per share for each class of common stock and participating securities according to their participation rights in dividends and undistributed earnings or losses. Non-vested restricted stock that includes non-forfeitable rights to dividends are considered participating securities.

Because we have incurred a net loss for all periods presented, diluted net loss per common share is the same as basic net loss per common share. The following contingently issuable and convertible equity shares were excluded from the calculation of diluted net loss per share because their effect would have been anti-dilutive for all periods presented:

	Six Months Ended June 30,	
	2019	2018
Restricted stock	307,347	167,593
Stock options	90,685	135,365
Warrants	4,979	44,101
	<u>403,011</u>	<u>347,059</u>

NOTE 10 – BUSINESS SEGMENT

Operating segments are defined as components of an enterprise for which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance. We have one operating and reporting segment, OrthoPediatrics Corp., which designs, develops and markets anatomically appropriate implants and devices for children with orthopedic problems. Our chief operating decision-maker, our Chief Executive Officer, reviews financial information presented on a consolidated basis for purposes of making operating decisions and assessing financial performance, accompanied by disaggregated revenue information by product category. We disaggregate revenue from contracts with customers by operating segment. We determined that disaggregating revenue into these categories achieves the disclosure objective of illustrating the differences in the nature, timing and uncertainty of our revenue streams. We do not assess the performance of our individual product categories on measures of profit or loss, or other asset-based metrics. Therefore, the information below is presented only for revenue by category and geography.

Product sales attributed to a country or region includes product sales to hospitals, physicians and distributors and is based on the final destination where the products are sold. No individual customer accounted for more than 10% of total product sales for the three and six months ended June 30, 2019 or 2018. No customer accounted for more than 10% of consolidated accounts receivable as of June 30, 2019 and December 31, 2018.

Product sales by source were as follows:

Product sales by geographic location:	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
U.S.	\$ 13,848	\$ 11,458	\$ 24,115	\$ 20,111
International	4,352	3,619	8,741	7,060
Total	\$ 18,200	\$ 15,077	\$ 32,856	\$ 27,171

Product sales by category:	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Trauma and deformity	\$ 11,887	\$ 9,860	\$ 21,904	\$ 18,983
Scoliosis	5,866	4,897	10,124	7,582
Sports medicine/other	447	320	828	606
Total	\$ 18,200	\$ 15,077	\$ 32,856	\$ 27,171

No individual country with sales originating outside of the United States accounted for more than 10% of consolidated revenue for the three and six months ended June 30, 2019 and 2018.

NOTE 11 - RELATED PARTY TRANSACTIONS

In addition to the debt and credit agreements and mortgage with Squadron and its affiliate (see Note 3), we currently use Structure Medical, LLC ("Structure Medical") as one of our suppliers. Structure Medical is affiliated with Squadron and we do not have a long-term contract with them. We made aggregate payments to Structure Medical of \$1,729 and \$1,565 for the three months ended June 30, 2019 and 2018, respectively, and \$2,493 and \$2,266 for the six months ended June 30, 2019 and 2018, respectively.

NOTE 12 - EMPLOYEE BENEFIT PLAN

We have a defined-contribution plan, OrthoPediatrics 401(k) Retirement Plan (the "401(k) Plan"), which includes a cash or deferral (Section 401(k)) arrangement. The 401(k) Plan covers those employees who meet certain eligibility requirements and elect to participate. Employee contributions are limited to the annual amounts permitted under the Internal Revenue Code. The 401(k) Plan allows us to make a discretionary matching contribution. Discretionary matching contributions are determined annually by management. Effective January 1, 2018, we have elected to match our employees' 401(k) contributions up to 3% of employees' salary.

NOTE 13 – COMMITMENTS AND CONTINGENCIES

Leases

At the inception of a contractual arrangement, the Company determines whether the contract contains a lease by assessing whether there is an identified asset and whether the contract conveys the right to control the use of the identified asset in exchange for consideration over a period of time. If both criteria are met, the Company calculates the associated lease liability and corresponding right-of-use asset upon lease commencement using a discount rate based on a borrowing rate commensurate with the term of the lease.

The Company records lease liabilities within current liabilities or long-term liabilities based upon the length of time associated with the lease payments. The Company records its operating lease right-of-use assets as long-term assets.

The Company leases an office facility in Florida for the Orthex business acquired in June. The term of the lease is 4 years and provides for periodic rent increases. The lease agreement does not contain any material variable lease payments, a residual value guarantee or material restrictive covenants.

As of June 30, 2019, the Company has recorded a lease liability of \$75 and corresponding right-of-use-asset of \$75 on its condensed consolidated balance sheet.

Legal Proceedings

From time to time, we are involved in various legal proceedings arising in the ordinary course of our business. On January 20, 2017, K2M, Inc. filed suit against us in the United States District Court for the District of Delaware (K2M, Inc. v. OrthoPediatrics Corp. et al., Case No. 1:17-cv-0061) seeking unspecified damages for alleged infringement of U.S. Patent No. 9,532,816. The complaint was amended on August 21, 2017 to add, among other things, a claim of patent infringement regarding U.S. Patent No. 9,655,664. These patents relate to certain instruments used in our RESPONSE™ spine systems, which represent a portion of our total scoliosis portfolio. We have denied these claims and responded with counterclaims seeking declaratory relief that the patents in question are both invalid and not infringed. The parties attended a court-ordered mediation on October 24, 2017, which did not resolve the dispute, but as we move forward with this matter we welcome constructive discussions on a negotiated settlement. Nevertheless, we view our case as particularly strong and will continue to vigorously defend this matter. On January 8 and 22, 2018, we filed our first and second petitions for inter partes review ("IPR") with the United States Patent and Trademark Office's Patent Trial and Appeal Board ("PTAB") to challenge the patentability of U.S. Patent No. 9,532,816 (OrthoPediatrics Corp., v. K2M, Inc., Inter Partes Case Nos. IPR2018-00429 and IPR2018-00521). On June 28, 2018, the PTAB instituted the subject IPRs and set a trial date of February 20, 2019 for both IPRs. Due to inclement weather, the subject February 20 hearing was postponed and took place on February 21, 2019. On June 4, 2019, we learned PTAB ruled against OrthoPediatrics with respect to its challenge of the validity of K2M, Inc.'s U.S. Patent No. 9,532,816. In early July 2019, we sought a rehearing of PTAB's decision and was notified on July 23, 2019 PTAB

denied our rehearing request. Additionally, the parties have agreed to stay the above-referenced district court proceedings pending the outcome of the subject IPR proceedings. The Court ordered the stay on July 10, 2018. To date, the stay has not been lifted. Moreover, on August 21, 2018, we filed three petitions with PTAB to challenge the patentability of the above-referenced U.S. Patent No. 9,655,664 (OrthoPediatrics Corp., v. K2M, Inc., Inter Partes Case Nos. IPR2018-01546, IPR2018-01547, and IPR2018-01548). On February 14 and 22, 2019 and March 1, 2019, PTAB declined to initiate IPR Case Nos. IPR2018-01546, IPR2018-01547, and IPR2018-01548, respectively. Although we believe that the K2M lawsuit is without merit and will vigorously defend the claims asserted against us, intellectual property litigation can involve complex factual and legal questions, and an adverse resolution of this proceeding could have a material adverse effect on our business, operating results and financial condition.

We are not presently a party to any other legal proceedings the outcome of which, if determined adversely to us, would individually or in the aggregate materially affect our financial position or results of operations or cash flows.

Royalties

As of June 30, 2019, we are contracted to pay royalties to individuals and entities that provide research and development services, which range from 0.5% to 20% of sales. Additionally, we have minimum royalty commitments of \$500 annually through 2026.

We have products in development that have milestone payments and royalty commitments. In any development project, there are significant variables that will affect the amount and timing of these payments and as of June 30, 2019, we have not been able to determine the amount and timing of payments. We do not anticipate these future payments will have a material impact on our financial results.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the condensed consolidated financial statements and related notes thereto contained elsewhere in this quarterly report, as well as the information under "Note Regarding Forward-Looking Statements."

Overview

We are the only medical device company focused exclusively on providing a comprehensive product offering to the pediatric orthopedic market in order to improve the lives of children with orthopedic conditions. We design, develop and commercialize innovative orthopedic implants and instruments to meet the specialized needs of pediatric surgeons and their patients, who we believe have been largely neglected by the orthopedic industry. We currently serve three of the largest categories in this market. We estimate that the portion of this market that we currently serve represents a \$3.2 billion opportunity globally, including over \$1.4 billion in the United States.

We sell implants and instruments to our customers for use by pediatric orthopedic surgeons to treat orthopedic conditions in children. We provide our implants in sets that consist of a range of implant sizes and include the instruments necessary to perform the surgical procedure. In the United States, our customers typically expect us to have full sets of implants and instruments on site at each hospital but do not purchase the implants until they are used in surgery. Accordingly, we must make an up-front investment in inventory of consigned implants and instruments before we can generate revenue from a particular hospital and we maintain substantial levels of inventory and instruments at any given time.

We currently market 29 surgical systems that serve three of the largest categories within the pediatric orthopedic market: (i) trauma and deformity, (ii) scoliosis and (iii) sports medicine/other. We rely on a broad network of third parties to manufacture the components of our products, which we then inspect and package. We believe our innovative products promote improved surgical accuracy, increase consistency of outcomes and enhance surgeon confidence in achieving high standards of care. In the future, we expect to expand our product offering within these categories, as well as to address additional categories of the pediatric orthopedic market.

The majority of our revenue has been generated in the United States, where we sell our products through a network of 34 independent sales agencies employing more than 152 sales representatives specifically focused on pediatrics. These independent sales agents are trained by us, distribute our products and are compensated through sales-based commissions and performance bonuses. We do not sell our products through or participate in physician-owned distributorships, or PODs.

We market and sell our products internationally in 43 countries, primarily through independent stocking distributors. Our independent distributors manage the billing relationship with each hospital in their respective territories and are responsible for servicing the product needs of their surgeon customers. In April 2017, we began to supplement our use of independent distributors with direct sales programs in the United Kingdom, Ireland, Australia and New Zealand and further expanded to Canada in September 2018 and Belgium and the Netherlands in January 2019. In these markets, we work through sales agencies that are paid a commission, similar to our U.S. sales model. We expect these arrangements to generate an increase in revenue and gross margin.

We believe there are significant opportunities for us to strengthen our position in U.S. and international markets by increasing investments in consigned implant and instrument sets, strengthening our global sales and distribution infrastructure and expanding our product offering.

Emerging Growth Company and Smaller Reporting Company Status

The condensed consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") and reflect the financial position, results of operations, and cash flows of OrthoPediatics Corp (the "Company," "we," "our" or "us"). We qualify as an "emerging growth company" as defined in the Jumpstart Our Business Startups Act (the "JOBS Act"). For as long as a company is deemed to be an emerging growth company, it may take advantage of specified reduced reporting and other regulatory requirements that are generally unavailable to other public companies. We also qualify as a "smaller reporting company," as such term is defined in Rule 12b-2 under the Exchange Act. To the extent that we continue to qualify as a smaller reporting company, after we cease to qualify as an emerging growth company, certain of the exemptions available to us as an emerging growth company may continue to be available to us as a smaller reporting company. The JOBS Act also provides that an emerging growth company can delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. We have irrevocably elected not to avail ourselves of this exemption from new or revised accounting standards and, therefore, we are subject to the same new or revised accounting standards as other public companies that are not emerging growth companies.

Summary of Statements of Operations for the Three and Six Months Ended June 30, 2019 and 2018

The following table sets forth our results of operations for the three and six months ended June 30, 2019 and 2018:

	Three Months Ended June 30,				Six Months Ended June 30,			
	2019	2018	Increase (Decrease)	%	2019	2018	Increase (Decrease)	%
Net revenue	\$ 18,200	\$ 15,077	\$ 3,123	21 %	\$ 32,856	\$ 27,171	\$ 5,685	21 %
Cost of revenue	4,581	3,807	774	20 %	8,582	6,982	1,600	23 %
Sales and marketing expenses	7,606	6,776	830	12 %	14,153	12,855	1,298	10 %
General and administrative expenses	6,569	5,499	1,070	19 %	12,181	11,516	665	6 %
Research and development expenses	1,234	1,115	119	11 %	2,447	2,333	114	5 %
Other expenses	669	572	97	17 %	972	1,177	(205)	(17) %
Net loss from continuing operations	\$ (2,459)	\$ (2,692)	\$ (233)	(9) %	\$ (5,479)	\$ (7,692)	\$ (2,213)	(29) %
Loss from discontinued operations	\$ (159)	\$ —	\$ (159)	— %	\$ (159)	\$ —	\$ (159)	— %
Net loss	\$ (2,618)	\$ (2,692)	\$ (74)	(3) %	\$ (5,638)	\$ (7,692)	\$ (2,054)	(27) %

Net Revenue

The following tables set forth our net revenue by geography and product category for the three and six months ended June 30, 2019 and 2018:

Product sales by geographic location:	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
U.S.	\$ 13,848	\$ 11,458	\$ 24,115	\$ 20,111
International	4,352	3,619	8,741	7,060
Total	\$ 18,200	\$ 15,077	\$ 32,856	\$ 27,171

Product sales by category:	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Trauma and deformity	\$ 11,887	\$ 9,860	\$ 21,904	\$ 18,983
Scoliosis	5,866	4,897	10,124	7,582
Sports medicine/other	447	320	828	606
Total	\$ 18,200	\$ 15,077	\$ 32,856	\$ 27,171

Net revenue increased \$3.1 million, or 21%, from \$15.1 million for the three months ended June 30, 2018 to \$18.2 million for the three months ended June 30, 2019. The increase was due to trauma and deformity sales growth of \$2.0 million, or 21%, primarily driven by sales of our Pediatric Nailing Platform | Femur products, scoliosis sales growth of \$1.0 million, or 20%, primarily driven by sales of our FIREFLY® Pedicle Screw Navigation Guides and BandLoc DUO products and sports medicine/other sales growth of \$0.1 million, or 40%. Nearly all the change in each category was due to an increase in the unit volume sold and not a result of price changes.

Net revenue increased \$5.7 million, or 21%, from \$27.2 million for the six months ended June 30, 2018 to \$32.9 million for the six months ended June 30, 2019. The increase was due to trauma and deformity sales growth of \$2.9 million, or 15%, primarily driven by sales of our Pediatric Nailing Platform | Femur and PediPlate products, scoliosis sales growth of \$2.5 million, or 34%, primarily driven by sales of our RESPONSE and FIREFLY® Pedicle Screw Navigation Guides and sports medicine/other sales of \$0.2 million, or 37%. Nearly all the change in each category was due to an increase in the unit volume sold and not a result of price changes.

Cost of Revenue and Gross Margin

Cost of revenue increased \$0.8 million, or 20%, from \$3.8 million for the three months ended June 30, 2018 to \$4.6 million for the three months ended June 30, 2019. The increase was due primarily to increased sales volume in both the U.S. and international markets, including instrument sets. Gross margin was 75% for the three months ended June 30, 2018 and 75% for the three months ended June 30, 2019.

Cost of revenue increased \$1.6 million, or 23%, from \$7.0 million for the six months ended June 30, 2018 to \$8.6 million for the six months ended June 30, 2019. The increase was due primarily to increased sales volume in both the U.S. and international markets, including instrument sets. Gross margin was 74% for the six months ended June 30, 2018 and 74% for the six months ended June 30, 2019.

Sales and Marketing Expenses

Sales and marketing expenses increased \$0.8 million, or 12%, to \$7.6 million for the three months ended June 30, 2019 from \$6.8 million for the three months ended June 30, 2018. Sales and marketing expenses increased \$1.3 million or 10% from \$12.9 million for the six months ended June 30, 2018 to \$14.2 million for the six months ended June 30, 2019. The increases for the three and six month periods were due primarily to increased sales commission expenses, driven by the increase in unit volume sold.

General and Administrative Expenses

General and administrative expenses increased \$1.1 million, or 19%, from \$5.5 million for the three months ended June 30, 2018 to \$6.6 million for the three months ended June 30, 2019. General and administrative expenses increased \$0.7 million, or 6%, from \$11.5 for the six months ended June 30, 2018 to \$12.2 million for the six months ended June 30, 2019. The increases for the three and six month periods were due primarily to increased resources to support the growth of the business. Depreciation and amortization expenses increased \$0.4 million, or 56%, from \$0.7 million for the three months ended June 30, 2018 to \$1.1 million for the three months ended June 30, 2019 and increased \$0.5 million, or 39%, for the six months ended June 30, 2019 from \$1.4 million for the six months ended June 30, 2018 to \$1.9 million for the six months ended June 30, 2019. The increases for the three and six month periods were primarily due to increased investments in consigned surgical instrument sets and amortization of intangible licenses.

Research and Development Expenses

Research and development expenses increased \$0.1 million, or 11%, from \$1.1 million for the three months ended June 30, 2018 to \$1.2 million for the three months ended June 30, 2019. Research and development expenses increased \$0.1 million, or 5%, from \$2.3 million for the six months ended June 30, 2018 to \$2.4 million for the six months ended June 30, 2019. The increases for the three and six month periods were driven by incremental product development including the addition of personnel and the growth of our business.

Other Expenses

Other expenses were \$0.7 million and \$0.6 million for the three months ended June 30, 2019 and 2018, and \$1.0 and \$1.2 for the six months ended June 30, 2019 and 2018, respectively. Other expenses consist primarily of interest expense on our long-term debt. Interest expense decreased in early 2019 compared to 2018 following our \$4 million payment on our revolving credit facility in late 2018, but increased in June due to the new \$30 million term loan.

Liquidity and Capital Resources

We have incurred operating losses since inception which resulted in negative cash flows for continuing operations from operating activities of \$10.8 million and \$11.7 million for the six months ended June 30, 2019 and 2018, respectively. As of June 30, 2019, we had an accumulated deficit of \$120.7 million. We anticipate that our losses will continue in the near term as we continue to expand our product portfolio and invest in additional consigned implant and instrument sets to support our expansion into existing and new markets. Since inception, we have funded our operations primarily with proceeds from the sales of our common and preferred stock, convertible securities and debt, as well as through sales of our products. At June 30, 2019, we had cash and cash equivalents of \$21.9 million.

In conjunction with the acquisition of Vilex and Orthex, the Company entered into a new \$30.0 million short-term loan facility with Squadron. The new term loan is due upon the the earliest of: (i) the date on which any persons acquire (x) capital stock of the Company possessing the voting power to elect a majority of the Company's Board of Directors (whether by merger, consolidation, reorganization, combination, sale or transfer), or (y) all or substantially all of the Company's assets, determined on a consolidated basis; (ii) the date on which the Company sells its equity interest in, or all or substantially all of the assets of, Vilex; and (iii) May 31, 2020. We believe our existing cash and cash equivalents and cash receipts from sales of our products will be sufficient to meet our anticipated cash requirements for more than the next twelve months.

Cash Flows

The following table sets forth our cash flows from operating, investing and financing activities for the periods indicated:

	Six Months Ended June 30,	
	2019	2018
Net cash used in operating activities - continuing operations	\$ (10,785)	\$ (11,673)
Net cash provided by operating activities - discontinued operations	371	—
Net cash used in investing activities - continuing operations	(58,610)	(4,347)
Net cash used in investing activities - discontinued operations	(47)	—
Net cash provided by (used in) financing activities	30,598	(56)
Net decrease in cash and cash equivalents	\$ (38,473)	\$ (16,076)

Cash Used in Operating Activities

Net cash used in operating activities from continuing operations was \$10.8 million and \$11.7 million for the six months ended June 30, 2019 and 2018, respectively. The primary use of this cash was to fund our operations related to the development and commercialization of our products in each of these years. Net cash used for working capital was \$8.2 million and \$8.0 million for the six months ended June 30, 2019 and 2018, respectively. During the six months ended June 30, 2019, the primary driver of working capital cash usage was the increase in inventory of \$5.3 million related to our sales growth.

Cash Used in Investing Activities

Net cash used in investing activities from continuing operations was \$58.6 million and \$4.3 million for the six months ended June 30, 2019 and 2018, respectively. Net cash used in investing activities consisted primarily of the acquisition of Vilex and Orthex of \$49.9 million, net of cash received, and the purchases of instrument sets, which were consigned in the United States, United Kingdom, Australia, New Zealand, Belgium and the Netherlands of \$8.5 million and \$4.2 million for the six months ended June 30, 2019 and 2018, respectively. We also purchased an additional \$0.2 million and \$0.2 million in new product licenses during the six months ended June 30, 2019 and 2018, respectively.

Cash Provided By (Used In) Financing Activities

Net cash provided by (used in) financing activities was \$30.6 million and \$(0.1) million for the six months ended June 30, 2019 and 2018, respectively. Net cash provided by financing activities for the six months ended June 30, 2019 consisted primarily of the proceeds from the \$30.0 million short-term debt borrowing related to the Vilex and Orthex acquisition and \$0.7 million from the exercise of stock options, which were offset by \$0.1 million in mortgage payments. Net cash used in financing activities consisted primarily of the payment of \$0.1 million in mortgage payments for the six months ended June 30, 2018.

Indebtedness

Loan Agreement

Effective December 31, 2017, we entered into a Fourth Amended and Restated Loan and Security Agreement, or the Loan Agreement, with Squadron Capital LLC, or Squadron, the Company's largest investor. Under the terms of the Loan Agreement, Squadron provided us a term loan in the principal amount of \$20.0 million, represented by a Term Note A, and a revolving loan in an aggregate principal amount to not exceed \$15.0 million, represented by a Revolving Note. Interest on the Term Note A and Revolving Note accrues at the greater of (a) three month LIBOR plus 8.61% and (b) 10.0%, and is payable monthly by us. The maturity date for each of the Term Note A and Revolving Note is January 31, 2023.

In order to finance a portion of the cash consideration for the acquisition of Vilex and Orthex, the Company entered into a first Amendment, or the Amendment, to the Loan Agreement with Squadron (as so amended, the "Amended Loan Agreement"). The Amended Loan Agreement provides for a new \$30.0 million term loan facility, represented by a Term Note B, in addition to the existing \$20.0 million Term Note A and \$15.0 million Revolving Note. Similar to the other facilities under the Amended Loan Agreement, the Term Note B is subject to interest only payments at an interest rate equal to the greater of (a) three month LIBOR plus 8.61%, and (b) 10.00%. The maturity date for the Term Note B is the earliest of: (i) the date on which any persons acquire (x) capital stock of the Company possessing the voting power to elect a majority of the Company's Board of Directors (whether by merger, consolidation, reorganization, combination, sale or transfer), or (y) all or substantially all of the Company's assets, determined on a consolidated basis; (ii) the date on which the Company sells its equity interest in, or all or substantially all of the assets of, Vilex; and (iii) May 31, 2020. Until such time that the Term Note B and all accrued interest thereon has been paid in full, no borrowings under the revolving loan facility are permitted.

As provided in the Amendment, Orthex has become a "Borrower" under the Amended Loan Agreement and, as such, granted to Squadron a security interest in all of its personal property as collateral for all borrowings under the Amended Loan Agreement. In connection with the Amendment, the Company granted a security interest in (a) the units of membership interest in Orthex held by the Company, and (b) the shares of stock of Vilex held by the Company, as collateral for borrowings under the Amended Loan Agreement. Borrowings under the Amended Loan Agreement are secured by substantially all of the Company's assets and are unconditionally guaranteed by each of its subsidiaries with the exception of Vilex.

At June 30, 2019, we had approximately \$49.9 million in outstanding indebtedness under the Amended Loan Agreement.

There are no traditional financial covenants associated with the Amended Loan Agreement. However, there are negative covenants that prohibit us from, among other things, transferring any of our material assets, merging with or acquiring another entity, entering into a transaction that would result in a change of control, incurring additional indebtedness, creating any lien on our property, making investments in third

parties and redeeming stock or paying dividends, in each case subject to certain exceptions as further detailed in the Amended Loan Agreement.

The Amended Loan Agreement includes events of default, the occurrence and continuation of any of which provides Squadron with the right to exercise remedies against us and the collateral securing the loans, including cash. These events of default include, among other things, the failure to pay amounts due under the credit facilities, insolvency, the occurrence of a material adverse event, which includes a material adverse change in our business, operations or properties (financial or otherwise) or a material impairment of the prospect of repayment of any portion of the obligations, the occurrence of any default under certain other indebtedness and a final judgment against us in an amount greater than \$250,000. The occurrence of a material adverse change could result in the acceleration of payment of the debt.

We are obligated to make monthly interest-only payments on the term loan facilities until the earlier of: (i) a transaction pursuant to which any person acquires (a) shares of our capital stock possessing the voting power to elect a majority of our board of directors or (b) all or substantially all of our assets on a consolidated basis; or (ii) January 31, 2023, at which point the term loan credit facilities, plus all accrued, unpaid interest thereon, will become due.

We may prepay the term loan facility in whole or in part without premium or penalty upon ten days' prior written notice to Squadron.

Mortgage Note

In August 2013, pursuant to the purchase of our office and warehouse space, we entered into a mortgage note payable to Tawani Enterprises Inc., the owner of which is a member of Squadron's Managing Committee. Pursuant to the terms of the mortgage note, we pay Tawani Enterprises Inc. monthly principal and interest installments of \$15,543, with interest compounded at 5% until maturity in August 2028, at which time a final payment of remaining principal and interest will become due. The mortgage is secured by the related real estate and building. The mortgage balance was \$1.4 million and \$1.4 million at June 30, 2019 and December 31, 2018, respectively.

Pediatric Orthopedic Business Seasonality

Our revenue is typically higher in the summer months and holiday periods, driven by higher sales of our trauma and deformity and scoliosis products, which is influenced by the higher incidence of pediatric surgeries during these periods due to recovery time provided by breaks in the school year. Additionally, our scoliosis patients tend to have additional health challenges that make scheduling their procedures variable in nature.

Critical Accounting Policies and Significant Judgments and Estimates

This management's discussion and analysis of financial condition and results of operations is based on our consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported revenue and expenses during the reporting periods. We monitor and analyze these items for changes in facts and circumstances, and material changes in these estimates could occur in the future. We base our estimates on historical experience and on various other factors that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Changes in estimates are reflected in reported results for the period in which they become known. Actual results may differ materially from these estimates under different assumptions or conditions.

For further information regarding our critical accounting policies, see "Note 2 - Significant Accounting Policies" of notes to condensed consolidated financial statements and our critical accounting policies within the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K filed with the SEC on March 7, 2019. There have been no material changes, other than the adoption of ASU 2016-02 "Leases", the purchase price accounting for the Vilex and Orthex acquisition and the discontinued operations presentation of Vilex during the three and six months ended June 30, 2019.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As a "smaller reporting company," we are not required to provide the information required by this item.

ITEM 4. CONTROLS AND PROCEDURES

a. Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) at the end of the period covered by this quarterly report.

Based on this evaluation, we concluded that, as of such date, our disclosure controls and procedures were effective to provide reasonable assurance that the information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

We recognize that any controls system, no matter how well designed and operated, can provide only reasonable assurance of achieving its objectives, and our management necessarily applies its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

b. Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the period covered by this quarterly report that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act).

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time, we are involved in various legal proceedings arising in the ordinary course of our business. On January 20, 2017, K2M, Inc. filed suit against us in the United States District Court for the District of Delaware (K2M, Inc. v. OrthoPediatics Corp. et al., Case No. 1:17-cv-0061) seeking unspecified damages for alleged infringement of U.S. Patent No. 9,532,816. The complaint was amended on August 21, 2017 to add, among other things, a claim of patent infringement regarding U.S. Patent No. 9,655,664. These patents relate to certain instruments used in our RESPONSE™ spine systems, which represent a portion of our total scoliosis portfolio. We have denied these claims and responded with counterclaims seeking declaratory relief that the patents in question are both invalid and not infringed. The parties attended a court-ordered mediation on October 24, 2017, which did not resolve the dispute, but as we move forward with this matter we welcome constructive discussions on a negotiated settlement. Nevertheless, we view our case as particularly strong and will continue to vigorously defend this matter. On January 8 and 22, 2018, we filed our first and second petitions for inter partes review ("IPR") with the United States Patent and Trademark Office's Patent Trial and Appeal Board ("PTAB") to challenge the patentability of U.S. Patent No. 9,532,816 (OrthoPediatics Corp., v. K2M, Inc., Inter Partes Case Nos. IPR2018-00429 and IPR2018-00521). On June 28, 2018, the PTAB instituted the subject IPRs and set a trial date of February 20, 2019 for both IPRs. Due to inclement weather, the subject February 20 hearing was postponed and took place on February 21, 2019. On June 4, 2019, we learned PTAB ruled against OrthoPediatics with respect to its challenge of the validity of K2M, Inc.'s U.S. Patent No. 9,532,816. In early July 2019, we sought a rehearing of PTAB's decision and was notified on July 23, 2019 PTAB denied our rehearing request. Additionally, the parties have agreed to stay the above-referenced district court proceedings pending the outcome of the subject IPR proceedings. The Court ordered the stay on July 10, 2018. To date, the stay has not been lifted. Moreover, on August 21, 2018, we filed three petitions with PTAB to challenge the patentability of the above-referenced U.S. Patent No. 9,655,664 (OrthoPediatics Corp., v. K2M, Inc., Inter Partes Case Nos. IPR2018-01546, IPR2018-01547, and IPR2018-01548). On February 14 and 22, 2019 and March 1, 2019, PTAB declined to initiate IPR Case Nos. IPR2018-01546, IPR2018-01547, and IPR2018-01548, respectively. Although we believe that the K2M lawsuit is without merit and will vigorously defend the claims asserted against us, intellectual property litigation can involve complex factual and legal questions, and an adverse resolution of this proceeding could have a material adverse effect on our business, operating results and financial condition.

We are not presently a party to any other legal proceedings the outcome of which, if determined adversely to us, would individually or in the aggregate have a material adverse effect on our business, operating results or financial condition.

ITEM 1A. RISK FACTORS

In addition to the other information set forth in this quarterly report, you should carefully consider the factors discussed in "Risk Factors" in our Annual Report on Form 10-K filed with the SEC on March 7, 2019. There have been no material changes to these Risk Factors since the filing of our Annual Report on Form 10-K.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

a. Sale of Unregistered Securities.

None.

b. Use of Proceeds.

On October 11, 2017, our Registration Statement on Form S-1 (File No. 333-212076) relating to our initial public offering of our common stock, or our IPO, was declared effective by the SEC. Pursuant to our IPO, we issued and sold 4.6 million shares of common stock at a public offering price of \$13.00 per share for aggregate gross proceeds of \$59.8 million. We received approximately \$46.9 million in net proceeds after deducting \$4.2 million of underwriting discounts and commissions, paying approximately \$2.7 million of offering costs and paying approximately \$6.0 million of Series B dividends.

As of June 30, 2019, all of the net proceeds have been used primarily to purchase implant sets for consignment to our customers, to fund research and development activities, to expand our sales and marketing programs, for working capital and other general corporate purposes, and to acquire complimentary products, technologies and businesses.

c. Issuer Purchases of Equity Securities.

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

None.

ITEM 5. OTHER INFORMATION

a. Failure to file under Form 8-K.

None.

b. Modifications to nomination process.

None.

ITEM 6. EXHIBITS

The following exhibits are included within this Report or incorporated herein by reference.

Exhibit Number	Description
3.1	Amended and Restated Certificate of Incorporation of OrthoPediatics Corp. (Incorporated by reference to Exhibit 3.1 of registrant's Form 8-K filed on October 16, 2017).(SEC File No. 001-38242)
3.2	Amended and Restated Bylaws of OrthoPediatics Corp. (Incorporated by reference to Exhibit 3.2 of registrant's Form 8-K filed on October 16, 2017).(SEC File No. 001-38242)
4.1	Specimen stock certificate evidencing the shares of common stock (Incorporated by reference to Exhibit 4.1 of registrant's Amendment No. 3 to Form S-1 filed on October 2, 2017) (SEC File No. 333-212076)
4.2	Registration Rights Agreement, by and between the registrant and Squadron, dated as of May 30, 2014 (Incorporated by reference to Exhibit 4.2 of registrant's Form S-1 filed on June 16, 2016) (SEC File No. 333-212076)
4.3	First Amendment to Registration Rights Agreement, by and between the registrant and Squadron, dated October 16, 2017 (Incorporated by reference to Exhibit 10.2 of registrant's Form 8-K filed on October 16, 2017).(SEC File No. 001-38242)
4.4	Stockholders Agreement, by and between the registrant and Squadron, dated October 16, 2017 (Incorporated by reference to Exhibit 10.1 of registrant's Form 8-K filed on October 16, 2017) (SEC File No. 001-38242)
10.1	Fourth Amended and Restated Loan Agreement, by and among the registrant, its subsidiaries and Squadron, dated as of December 31, 2017 (Incorporated by reference to Exhibit 10.1 of registrant's Form 8-K filed on January 8, 2018) (SEC File No. 001-38242)
10.2	Second Amended and Restated Term Note A, by and among the registrant, its subsidiaries and Squadron, dated as of December 31, 2017 (Incorporated by reference to Exhibit 10.2 of registrant's Form 8-K filed on January 8, 2018) (SEC File No. 001-38242)
10.3	Revolving Note, by and among the registrant, its subsidiaries and Squadron, dated as of December 31, 2017 (Incorporated by reference to Exhibit 10.3 of registrant's Form 8-K filed on January 8, 2018) (SEC File No. 001-38242)
10.4	First Amendment to the Fourth Amended and Restated Loan Agreement, dated as of June 4, 2019, by and among OrthoPediatics Corp., its subsidiaries named therein and Squadron Capital LLC (Incorporated by reference to Exhibit 10.2 of registrant's Form 8-K filed on June 5, 2019) (SEC File No. 001-38242)
10.5	Term Note B, dated June 4, 2019, made payable, jointly and severally, by OrthoPediatics Corp. and each of its subsidiaries party thereto (Incorporated by reference to Exhibit 10.3 of registrant's Form 8-K filed on June 5, 2019) (SEC File No. 001-38242)
31.1	Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	++ XBRL Instance Document (The instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.)
101.SCH	++ Inline XBRL Taxonomy Extension Schema Document
101.CAL	++ Inline XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	++ Inline XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	++ Inline XBRL Taxonomy Extension Label Linkbase Document
101.PRE	++ Inline XBRL Taxonomy Extension Presentation Linkbase Document
104	++ Cover Page Interactive Data File (formatted as Inline XBRL and included in Exhibit 101)

+ Exhibits that are filed with this Report (other than through incorporation by reference to other disclosures or exhibits).

++ Filed herewith as an Interactive Data File.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

August 13, 2019

ORTHOPEDIATRICS CORP.

By: /s/ Mark C. Throdahl

Mark C. Throdahl
President and Chief Executive Officer

August 13, 2019

By: /s/ Fred L. Hite

Fred L. Hite
Chief Financial Officer

CERTIFICATION PURSUANT TO RULE 13a-14(a)/15d-14(a)
OF THE SECURITIES EXCHANGE ACT OF 1934,
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Mark C. Throdahl, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of OrthoPediatrics Corp.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with general accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Mark C. Throdahl

Mark C. Throdahl
President and Chief Executive Officer
(Principal Executive Officer)

Date: August 13, 2019

CERTIFICATION PURSUANT TO RULE 13a-14(a)/15d-14(a)
OF THE SECURITIES EXCHANGE ACT OF 1934,
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Fred L. Hite, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of OrthoPediatrics Corp.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with general accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Fred L. Hite

Fred L. Hite
Chief Financial Officer
(Principal Financial Officer)

Date: August 13, 2019

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of OrthoPediatics Corp. (the "Company") for the quarterly period ended June 30, 2019, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Mark C. Throdahl, President and Chief Executive Officer of the Company, hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to his knowledge:

1. the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. the information contained in the Report fairly presents, in all material aspects, the financial condition and results of operations of the Company.

This certificate is being furnished solely for purposes of Section 906 and is not being filed as part of the Report.

/s/ Mark C. Throdahl

Mark C. Throdahl
President and Chief Executive Officer
(Principal Executive Officer)

Date: August 13, 2019

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of OrthoPediatrics Corp. (the "Company") for the period ended June 30, 2019, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Fred L. Hite, Chief Financial Officer of the Company, hereby certifies, pursuant to 18 Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to his knowledge:

1. the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. the information contained in the Report fairly presents, in all material aspects, the financial condition and results of operations of the Company.

This certificate is being furnished solely for purposes of Section 906 and is not being filed as part of the Report.

/s/ Fred L. Hite

Fred L. Hite

Chief Financial Officer

(Principal Financial Officer)

Date: August 13, 2019