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Q2 2019 Merit Medical Systems Inc Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the MMSI Q2 2019 Earnings Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded for replay purposes.

It is now my pleasure to hand the conference over to Mr. Fred Lampropoulos, Chairman and Chief Executive Officer. You may begin.

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

Good afternoon, ladies and gentlemen. This is Fred Lampropoulos, Chairman and CEO, and we are broadcasting this afternoon from very warm Salt Lake City, Utah. Thank you for taking the time to join us. We have, I think, a lot of very, very important information to share with you. But before doing that, I'd like to turn the time over to Brian Lloyd, our General Counsel, to read our safe harbor provision. Brian?

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

Thank you, Fred. During our discussion today, reference may be made to projections, anticipated events or other information which is not purely historical. Please be aware that statements made in this call, which are not purely historical, may be considered forward-looking statements. We caution you that all forward-looking statements involve risks, unanticipated events and uncertainties that could cause our actual results to differ materially from those anticipated in such statements. Many of these risks are discussed in our annual report on Form 10-K and other reports and filings with the Securities and Exchange Commission, and are available on our website. Some of these risks are identified in our press release, and slide presentation distributed in connection with this call. Any forward-looking statements made in this call are made only as of today's date, and except as required by law or regulation, we do not assume any obligation to update any such statements, whether as a result of new information, future events or otherwise.

Please refer to the section of our presentation entitled Disclosure regarding forward-looking statements for important information regarding such statements.

Our financial statements are prepared in accordance with accounting principles which are generally accepted in the United States. However, we believe certain non-GAAP financial measures provide investors with useful information regarding the underlying business trends and performance of our ongoing operations and can be useful for period-over-period comparisons of such operations.

The tables included in our release and discussed on this call set forth supplemental financial data and corresponding reconciliations to GAAP financial statements. Please refer to the sections of our presentation entitled Non-GAAP Financial Measures and Notes to Non-GAAP Financial Measures for important information regarding non-GAAP financial measures discussed on this call.

Readers should consider non-GAAP measures in addition to, not as a substitute for, financial reporting measures prepared in accordance with GAAP. These non-GAAP financial measures may exclude some items that affect net income. Additionally, these calculations may not be comparable with similarly titled measures of other companies.

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

Brian, thank you very much. And again, ladies and gentlemen, thank you for joining us. Well, I think as you can see, the second quarter was somewhat difficult for us. I want to make sure that everybody understands upfront that this has not dampened our enthusiasm for the business. And to be reminded that Merit looks things -- at things on an annual basis. Now I understand we have to look at all of the things when we report quarterly, so I don't want to be dismissive of that. But I think the best thing to do right now would be to turn some time over to Raul Parra, our Chief Financial Officer, to go through and talk about what some of the effects were that determined the outcome of the numbers. And then I will come back when he is finished and talk to you about things that are in place or working that I think you'll find of interest. So let me turn this time over, Raul, to you.

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

Thanks, Fred. So I'll start with revenue and just walk through the different line items on the financial statements. Revenue for the second quarter was approximately $256 million as reported, an approximate 13% increase over the comparable period of 2018 and approximately 10% on an organic constant currency basis. With the continued strength in the U.S. dollar, FX headwinds were approximately $5 million. The FX headwinds are mostly from the euro, CNY and emerging markets, with the CNY having the most impact on both revenue and earnings with the offset in the earnings amount with the euro. Additionally, Aspira and [define] are behind our forecast by approximately $3 million and $2.5 million behind the comparable period. Acquired products contributed revenue of $14 million with Cianna and ClariVein contributing $11.2 million and $1.7 million, respectively. Cianna continues to be within our previously provided guidance, while ClariVein has fallen behind by approximately $2 million. The unexpected sales shortfall for ClariVein was the result of excess inventory of some of the distributors prior to our acquisition. We believe we have made it past that, and sales are ramping to our expectations.

Contributions from our sales divisions to our organic constant currency line were as follows: worldwide dealers at 21%; Sensors at 22%; EMEA at 10%; U.S. direct and OEM contributing 5%; and Endotek coming in flat.

Moving on to the gross margin. Gross margin on an adjusted basis was 48.7% in the quarter. On a performance basis, gross margin was down 20 basis points compared to the comparable prior year quarter and up 70 basis points year-over-year, both clearly behind our expectations which we will address later in the call. This reflects an adjusted margin decline in the quarter as compared to the prior year, which was negatively impacted by FX of 20 basis points due to the strengthening of the U.S. dollar, tariffs by 25 basis points, an unfavorable product mix of 102 basis points. The 2 largest components of the unfavorable mix were our IOS division and Aspira sales, which accounted for 33 and 29 basis points, respectively. These unfavorable impacts were partially offset by 107 basis contribution from Cianna and ClariVein, and improvement in manufacturing branches over the prior comparable period of 21 basis points.

On operating expenses, as we discussed in our Q1 call, total operating expenses as a percentage of revenue on an adjusted basis were down sequentially as a percentage of revenue, and flat as a percentage of revenue compared to the prior year comparable period at approximately 35%. Tax rate on a non-GAAP basis for the quarter was 23% compared to 17% for the comparable period. The difference in the tax rate was primarily driven by the decrease in stock option exercise, which, as we know, gave us a benefit in the quarter.

EPS GAAP earnings were $0.12 as compared to $0.21 for the comparable period, non-GAAP earnings were $0.42 for the quarter as compared to $0.43 for the comparable period. EPS was below our expectations as a result of the gross margin product sales mix and the FX headwinds of $0.02.

A few other items of interest for everyone. Debt balance was $400 million with a cost of debt of approximately 3.1%, and our leverage ratio was 2.33% on a gross basis and 2.17% on a net basis. We paid our debt down an additional $12 million in Q2 for a total paydown year-to-date of $23 million, excluding any acquisitions or contingent payments. As you recall, we guided a pay down of approximately $40 million to $45 million, so we are on track for that.

Working capital was approximately $249 million. CapEx for the quarter came in at $17.6 million, D&A of approximately $22.7 million and stock comp expense of $2.5 million. Do you want to go into the updated guidance, Fred, or?

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

Yes. No. Why don't you do that and then I'll come in and right after that, Raul?

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

So let's cover that. Our guidance will be updated to reflect a couple of things that we are experiencing during the first half of the year. We're adjusting for the FX headwinds that we continue to see in the euro, CNY and emerging markets, the change in our product mix and for our most recent acquisition, Brightwater. We are adjusting our previous reported revenue guidance of $1.01 billion to $1.03 billion for the potential incremental impact of FX headwinds of $3 million to $4 million, assuming the prevailing FX rates persist in the second half of the year.

We will keep noncore in line with our previous guidance at $62 million to $66 million. Noncore revenue is Cianna, Vascular Insights, BD, NinePoint, Brightwater and a few other acquisitions. We will maintain our core growth on a constant currency basis of approximately 8% to 10% with the only adjustment to our reported revenue coming from FX. The new range is now for $7 million to $11 million from $5 million to $7 million.

Gross margin on a GAAP basis will be between 44.1% and 44.8%. Gross margin on a non-GAAP basis will be between 49.2% and 49.9%, an improvement of 25 to 100 basis points. The change in our margins is coming from what we have seen in the first half of the year, which is FX headwinds, tariffs and the demand on our legacy products, which have lower margins than our corporate margins, along with the unfavorable sales mix from our IOS division and Aspira sales. We continue to execute our disciplined and operating expenses, and plan to do so for the remainder of the year in line with our historical spend of approximately 35%. Our forecast includes a tax rate in the range of 22.5% to 24.5% for the year, but are using a rate of approximately 26% for the second half of the year.

Interest expense of approximately $13 million, which updates the forecast for current market outlook of a rate cut. EPS GAAP will range between $0.62 and $0.84 for 2019. On a non-GAAP basis, the range will be between $1.74 and $1.97, which contemplates the FX headwinds of approximately $0.04 to $0.06, the change to our gross margin related to the product sales mix and a $0.03 decrease in -- related to the Brightwater acquisition.

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

Okay, Raul, thank you very much. It's -- that's a lot of numbers. It's a lot of information. Let me add some color to this and just discuss with you just a little bit of history here, recent history. Please be reminded of all of the calamity we saw over the last 3 to 4 months. We have the issues with China, issues with Mexico and jumping around and trying to figure out how products are going to move.

And of course, we've had the euro. Even today, I think the euro is sitting at lows. We have a new Prime Minister. And I've had several phone calls today, just asking about Merit's position and what we're doing with Brexit. And I'd like to refresh everybody's memory that Merit is prepared for Brexit, Merit opened up a new facility, and we do not anticipate, under any circumstances, other than acts of God, that we will have any issues that will affect our ability to meet our customers' needs. I think, again, people are saying, "Well, do you have a Brexit plan?" And we talked about it, and even on the last call, I had one of the analysts say to me, "Well, why do you talk about Brexit? Nobody else does." And the answer is because we have big interest in Europe, and it's a big part of our business. But I want to put you at ease in terms of that. Maybe it's not a concern, but I will tell you that from some of the shareholders that have been calling me over the last couple of days, it is kind of a concern for them.

Let me go on and talk a little bit about contracts. And really, what I'm trying to do is set a stage and, Raul, can pipe in on this whenever you want to. But as dismayed as you could be, we are not and then there are reasons for that. Let me go through this. A little bit in the press release, we're talking about the needs for our customers. There is a lot of stuff going on in the marketplace. There are issues that have to do with fluid administration which affects our legacy products. There are divestitures which are going to help us, and I'm going to talk about that in a minute. There are other issues to and including a number of contracts that we have signed, we have announced one of those, and that was with Premier. This very day, we have signed another one. Now because it's so fresh, we're not going to discuss names nor are we authorized to do so. But what I will say is that the fluid administration business is one that Merit is going to have a major opportunity over the next several years. And one might say, well, why are you doing that. And I think Raul will answer that. It is lower than our corporate average, but it is part of our core business and very much like the Cook situation a few years ago where we met customer needs. And by doing so, that business that we had of our -- eventually tripled. And so meeting your customers' needs and the pull-through is very, very important.

Now despite the issues with China, that business is still growing up into the upper teens and maybe as high as 20%. I didn't -- and I haven't addressed quite yet, but I think it was something that Raul at least alluded to, and that is, there is disruption in the marketplace with embolics. And as you may recall, the embolic business has essentially been flat for the last couple of years, and we saw in the second quarter, substantial growth, and I believe it was close, Raul, to 15% for the month -- in the month of June.

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

That's right.

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

And for the quarter, about 10%. Well we haven't seen that for a long time. And again, we're not going to mention names but there are companies that have divested or in the process of divesting. And these were former Embosphere customers, and we're already seeing phone calls and new business where they don't know who their sales rep is, and they don't have a relationship. And so consequently, we believe that a good portion of that business is going to come back. So if we look at embolics, we look at legacy, we look at China and we look at our pipeline of products, which just continues to release, and we think is a good opportunity. Raul, you wanted to make a comment.

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

Yes, I just -- speaking of China. China, on a reported basis, grew at 23% on an organic constant currency it grew at 31% for the quarter. So --

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

Yes. So there were these issues in terms of acquired products. I'm going to go to Aspira, that's part of the Becton, Dickinson issue. The challenge is it's still being made, still being the packaged and we can't do much in terms of new products or enhancements or growth in that area in Europe until it's in Mexico. So we believe that sometime in the early fourth quarter or in the mid-fourth quarter, not very far from now, all of the products from Becton, Dickinson that are currently being made in the Dominican Republic will be produced in Mexico at Merit Medical. And so that's another, I think, big improvement and opportunity that we -- it's been a great acquisition. There's one part fell down but we'll bring it back just like we'll bring back our spine business. So we have a number of new product introductions in our spine business. Now so that's on the product side.

So when we look at what we call the tailwinds, there's more than I think I've ever seen. We've never had exclusives. We have never been the primary provider in a number of these GPOs and with these other potential -- these other not potential, but contracts. And so we have that. And I think if you take a look at the core growth, even in the second quarter. And Raul, I want to compliment you, I think you laid it out exactly where those shortfalls were and they are short term. And as Raul pointed out, we're already seeing -- and to give you an example. In some of the ClariVein, which is we're short a little bit more than $2 million, there were some products that we have just started to deliver in the last 30 days. We haven't had an order all year because of pipeline filling from the former customer or fear by the distributor that somehow they wouldn't be able to keep it. And so consequently, and those things are surprises to us, we didn't expect that and those are high-margin products. But they are now ordering. And we think that, that storm or that delay is over.

So if you look at all the events that took place, I think we have explained them. They are short term or those storms are over. Now the FX and the things that we can't control. We just have to continue to play that out. We are working on making sure that our exposure is covered. But that's an issue that we hope comes back to some normalization but to this point.

So I'm going to come back now to the expense line. If you take a look at the SG&A line, even with those lower revenues, it was in line with what our general expectations are and how we guide. Had we hit those numbers, and we didn't, but those expenses would have been even lower. But what we have done as we saw this play out. We've met with our staff, we've met with all of the stakeholders and the auxiliaries at Merit and said, okay, we need to tighten up here. We need to change our habits here. So we're not just like taking this and saying well everything will just be fine. We're doing something about it, and you will see that through the balance of this year. And I think the other thing that we looked at was the guidance. And there may be some of you who are chasing from us because we haven't changed next year's guidance, we just have such confidence in the business. And we're not trying to be foolish. This would be the time to do those sorts of things. We think we need to adjust it for the performance in the first half. We're confident as we move through the second half, and we feel confident enough that we don't want to go change numbers that we'd have to change again because we're so positive on the pipeline, the contracts, the new products, the new approvals and so on and so forth.

So at the end. It's a great business. Our customers want to do business with us, the business continues to grow in Europe, in Asia and the U.S. And we see that those tailwinds, which we alluded to before, but those contracts, those opportunities are in place. Now, they're not all going to ramp up in the third quarter, inventories have to be sold off or they have to be used up and this thing to ramp. But as we start to take a look, we will be gaining momentum. And we think as we move into 2020, that there are going to be great opportunities for this company. Albeit with a possibility of maybe a little bit less gross margin because of these legacy products. But nevertheless, gross margin dollars, opportunities. And as long as we maintain the balance and the discipline in the expense side of things, the company's going to actually prosper.

So today, may seem like a dark day, it's not. There was just a thunderstorm that came through town, and the thunderstorm has left. So you have to do your job, we'll do ours. Again, thank you for joining us, and we're going to be here this evening to take calls, we'll take questions now. And with that said, I think we'll turn our time over to the administrator, and we'll go ahead and we'll start taking your calls. So we'll turn the time back over to you, sir.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question will come from Jim Sidoti from Sidoti & Company.

James Philip Sidoti ***Sidoti & Company, LLC - Research Analyst***

Can you hear me?

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

I can, Jim, thank you for calling in.

James Philip Sidoti ***Sidoti & Company, LLC - Research Analyst***

Great, great. In the -- in your text, you talked a little bit about the new contract with Premier. But then you said there were some other GPOs that you started to work with. Can you give us any more color on that? And how quickly do you think that business will ramp up?

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

Yes, Jim. As I mentioned in my comments, we're somewhat limited in what we can say. Other than I think we can -- I think it's very evident that, that whole area is something that there is a lot of that business that's going to come to Merit. And there are a bunch of players out there but I think this transaction is a great opportunity. I know what I haven't mentioned a lot is all the throughput that comes through from the areas of the fluid management. So even though it's a lower margin, and I think I've talked quite a bit about this, there's a lot of throughput, there's a lot of gross margin dollars. And again, I think the important part I've tried to make understood is, these are the customers that have built our business. And you don't turn away from those. Raul, do you want to -- do you have anything on that one?

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

No. I'd just like to add that it does improve our operating margin, too, because we get to leverage those revenues. There's very little effort on our part as far as expense side.

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

Yes, that's right. We don't have to go build new tools. We have capacity, we have things in place. There's not much we have to do, we think now. I will say this, Jim, then it will be my last comment on this part of your questions, but these things are -- one being one account with Premier assigned and is in effect. But inventory has to be worked out and the transfer and the ramp-up. So you will see this start in the third. It will get stronger in the fourth. And by the time we get to early next year in that first quarter, and for the balance of that year, up to 5 years, this is going to be a big, big opportunity. And remember that this is the business that Merit started out in. This is the business that we wanted and felt like we can compete in. So again, much like the Cook opportunity. We think it's the right thing to do the business, and I'll let you know that we debated it, we talked about it. What do you think? Should we participate? Or should we not? And we have a lot of conversation with our FP&A guys and our ops guys to come to that conclusion. Listen, I think that's enough said, Jim, do you have anything else, and then I need to move on.

James Philip Sidoti ***Sidoti & Company, LLC - Research Analyst***

I just want to confirm, did this increased activity with the GPOS. Is this as a result of the AngioDynamics Medline deal. And have there been any other side effects in that deal that you can talk about?

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

Yes and no.

James Philip Sidoti ***Sidoti & Company, LLC - Research Analyst***

Okay. Any comment on the divestiture from Boston Scientific. Do you think that, that's the reason for the increased activity in embolics? And how do you think that will be?

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

Yes. Listen, we lost probably over 2 or 3 years when Boston came in to that kind of just in the U.S. about 400 accounts, most of it on price. But as you know, this is also one of the highest margin products in the company. And we've already seen the effects of that. Just a few minutes ago, I was checking to look on how many new accounts we opened today. And people that haven't bought, there's about 15 today that came in. And we've seen some conversions over in Europe as well. So I think there's a lot of opportunity there. And it'll start playing out, but I would be mindful to everybody that these transitions, the Varian deal has closed. The other conversation that we had has not finalized yet. And so -- but we feel pretty strongly about these opportunities. And I think it goes to what Raul said that is when you look at our pipeline, you look at things that we can fix. I mean, there's some things we can, like we can hedge, we -- by the way, I think I should tell them. We're doing more hedging on the currency side and doing things. But remember, we also get the benefit of a EUR 1 11 in terms of our expenses in Europe.

And our labor, we have 1,000 employees now in Ireland. So we picked up some, but as you can see by -- the net-net of it is, we lost more than we gained the portion. I mean, I think that's the net of it all. So you take a look at those in the pipeline of products. And listen, even on the biopsy products from Becton, Dickinson, it's a great transaction, but we have had our hands tied because of these regulatory issues and MDRs and things we can't do until everything is moved. So those shackles are going to come off and it's going to give us a lot more opportunity in that pipeline. So yes, listen, people are disappointed. I'm disappointed. I say that the thunderstorm has passed through. And maybe that's a little bit more, maybe the thunderstorm is right over the top of this. But the bottom line is, it will pass-through rather quickly. And as we look now look forward, we just see and we're very optimistic. And we talked about this, Jim, I'm going on too long, but we talked about, if people are going to believe us, so they're going to think this and think that. And we went back and everybody talked, we looked at the numbers, we looked at the momentum. And we said we feel comfortable with this. We understand when we make that statement, what it means. And that's where we are. So Jim, I want to thank you. I've got a bunch of folks. I hate to kick you off the call but I got to go.

Operator

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

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

Just to be clear on the 2020 outlook, Fred, I think you said in the past 8% to 10% top line, 100 to 150 basis points of margin expansion and then 14% to 19% EPS growth next year. That 14% to 19% is now off the lower base that you just guided us all to. You're not saying stick with where the Street came out, which was like 2 35 for next year. Is that correct?

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

That's correct.

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

That's correct.

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

Okay, That's helpful. And then just 2 more for me and I'll bundle them here together so we get to everybody else. But the gross margin outlook, down 150 basis points. I think, Raul, you talked about a couple of the headwinds there but you've also got the mix tailwind. So I'm just trying to marry up where all this additional pressure's coming from via these contracts. I mean, how low -- some of the gross margin that you're getting on some of these contracts. And is there an opportunity over time to take price up. And then, I guess, again, given that you were guiding so strongly for the overall business before. I mean why do you need to take on this new revenue that you hadn't expected before. And then, sorry, the other piece of the other question I have is on Cianna. It's a little bit lighter than I was modeling, it was down sequentially. So can you just talk about what's going on with that business.

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

Let me -- I'll let Raul hit the first part of that with Cianna.

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

Yes. On Cianna, we are slightly behind our forecast. But really, it's just a timing issue. The pipeline is pretty strong there. And we still feel pretty comfortable with the $50 million to $55 million we guided. So again, right there is just a timing issue on the capital side. It did contribute about 100 basis points to our margin. So we're still excited about it and a lot of momentum there.

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

Let me pick up the other parts of your question. One of the things that we have seen is, like, for instance, and these were the smaller ones. But if you look to the Vascular Insights or the ClariVein product. In one situation, Matt, we just received an order from South Korea. I mean, remember, we closed this deal in November, December, near the end of last year. And unfortunately, and I want to be careful about how I say this, because there are other things that we have to do, but we just got our first order in one of the largest franchises of that business, and that's because they took the -- the inventory was filled in the -- and again, I got to be careful here, but there was a lot of inventory, they just worked it off but what we are seeing and what we have seen for over the last month, as we're seeing now, that business is being ordered. So the Vascular Insights or ClariVein business is going to accelerate substantially in the second half of the year. So we're confident in that, and we're seeing that right now. So that's when we look at the embolic business.

Now going back to your question, why would you take this business? Well, first of all, we're in that business. We do it every day. We serve customers and get pulled through in relationships every single day. And if someone -- if these guys buy our inflation devices, they buy our embolics, they buy -- I mean, these hospitals buy these products. To say -- and there are a lot of really interesting dynamics here that I cannot talk about on the phone, but the relationships between a number of these organizations, buying groups, other companies that deal with this, it is really unique dynamics. And as we looked at it and saw what it would do for our operating margin since we don't have to add a lot; we already have the tools, we have the clean rooms, we have the packaging equipment; we think it's going to have a positive effect, as Raul indicated, on our operating margins because we don't have all those other expenses associated with our normal burdening of a product in costing. And again, these are the same people that buy our guidewires that are over 50%. They are the same people buy inflation devices.

So there's a lot of these products that, if you say that someone wouldn't provide them and you won't, even though they know you're in the business, what does it make you look like? How do you do that? And the answer is, we've made a decision, as a company, that it's in Merit's best long-term interest to serve our customers' needs. It might not very candidly, you're not going to like what I'm going to say. It might not meet the short-term needs of Wall Street, but it meets the long-term needs of our customers and our company, and we debated it mightily. We looked at what it meant and what we thought it would do and what it means for the company, and we said, look, this is the right thing to do.

As I said, when we went back to the Cook products, we didn't make any money on Cook products. We essentially sold them at the same price the Cook was selling them at, and they have the benefit of being the one to have volumes were 5, 10x what Merit did. Now I look down the road 3 years and that business has tripled. We're applying that overhead, and many of those customers are the same customers that are buying our new products and gave us insights. So we serve the customers' needs. It serves the company well and helped us to reduce our cost over time and it was the right thing to do. So we're not going to make short-term decisions for short-term needs and window dress. What we're going to do is what's right for our customers. But at the end of the day, as we all know, pay the bills and help us to provide earnings to reinvest into the future. So again, you may have a different point of view, but that's our point of view and that's how we're going to conduct the business.

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

Just real quick for Raul, is free cash flow still expected to be $40 million this year?

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

So again, I want to clarify that. We never guided on free cash flow. We did guide on debt paydown of $40 million to $45 million. We did pay about $23 million, so we're on track for that. Obviously, we hope to see free cash flow improve. We did go from negative free cash flow in Q1 to positive free cash flow of approximately $4.7 million in Q2.

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

That was a swing of about $8 million or $9 million, in that.

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

That's right.

Operator

And our next question will come from the line of Larry Biegelsen with Wells Fargo.

Adam Carl Maeder ***Wells Fargo Securities, LLC, Research Division - Associate Analyst***

It's Adam Maeder in for Larry. A couple of guidance-related questions from me. By our math, the first half gross margin was about 48.9%, which implies a second half gross margin of a little north than 50% to get you to the midpoint of the new gross margin guidance. So what's your level of confidence in delivering against your new outlook? And what are some of the levers that help you get there? And just any color on the cadence of gross margin in Q3 versus Q4? And then I have a follow-up.

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

Yes, we show gross margins kind of in the mid 49 -- or mid to high 49%. So 49.7%, 49.8% just to get to the back half, somewhere in there. So I'm not sure where the math is we can probably walk through that later, Adam, but we'll expect the gross margin to kind of ramp to mid to low 49% in Q3 and then kind of go up from there.

Adam Carl Maeder ***Wells Fargo Securities, LLC, Research Division - Associate Analyst***

Okay. And then on the EPS guidance, it's a pretty wide range. I think it's about $0.23. The old range was $0.11. So my question is why the wide range. And maybe what gets you to the high end and what gets to the low end of the EPS guidance.

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

Yes. No problem. And thank you for that question. It's a great question. I think, to be honest with you. It's how confident we are in the business and just how optimistic we are. I think it's dependent on when these contracts start to hit. There could be a lot of leverage to be had that would help us hit the high end of that range. And so we just felt like, based on where we're currently sitting at right now, and the information we have, we would be towards the lower end of that range. But if some of these contracts pick up earlier, there is a possibility that we could end up at that higher end of the range. And that's why we went with such a big spread.

Operator

And our next question will come from the line of Jason Mills with Canaccord Genuity.

Cecilia E. Furlong ***Canaccord Genuity Corp., Research Division - Associate***

This is actually Cecilia on for Jason. And I just wanted to ask, just following up on Cianna and recent progress. But could you just talk about how you're rolling that out to your own sales force in the U.S. And where you are in that process. And then just updates in Europe, just on the CE Mark and where you are there as well, please?

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

Yes, Cecilia, thank you very much. I think the thing that we had shared previously was that we decided to stay, and we maintained the Cianna sales force. I think that was the right thing to do. We've had a little bit of attrition but not much. And we are now starting to roll the Merit sales force and filling the areas that didn't have the attention. At the same time, on the manufacturing side, we're making all the monitors here in Salt Lake City. And of course, others are made by a vendor. So I think in terms of all the operational side of the business, that we put all those things into effect. This last weekend, we had a, I think, wire-free seminar trading here by physicians in Salt Lake City. We had 20 breast surgeons here and the enthusiasm from that group and in a couple of areas, I don't want to go specific, but there was one specific area, where we had a couple of physicians that were here, that represents over $1 million worth of business opportunity, which we -- I heard after the meeting was very, very positive. So that's what we've been. We'll continue to fortify and to build the business that way.

Now let me go to the European question, because I think that's one of the other areas. We originally thought that we could see the CE Mark in the fourth quarter or in the first quarter. And the fact of the matter is, we haven't seen it yet. And with Europe and the MDR and the notified bodies. It's going to be tough for anybody to get these things through. I mean, I've never seen this in my history, as of one time with the FDA going back to Kepler, the commissioner. This is in the first 4 years of the business, where everything came to a standstill. But everything in Europe is essentially at a standstill. So even looked at all of our products, and thought, which ones would be affected. Now, they are basically approved, all of our products there. But they newer ones are having a slower amount of time. I was told maybe late third, fourth quarter, that would put us almost a year behind. I will tell you, that Europe is clamoring for this product. I mean, we even had a situation in the other day, where one group of physicians are saying, well, we will get an IRB at the hospital to use this because it's necessary. Well, we're not going to violate the law. We're not going to do things that we shouldn't. But it's hard to tell what the hell is going on in Europe. I mean, I think if you watch the news, you'll see it. So that's the best way I can answer it. And I think you can see that I'm frustrated with it as well as you are. I can't even speak to say frustrated. I'm working on that one. But anyway, it's a challenge for us, so that's the answer, Cecilia.

Cecilia E. Furlong ***Canaccord Genuity Corp., Research Division - Associate***

Okay. I appreciate all the color. And then I just wanted to ask to just about the recent Brightwater Medical acquisition. Can you just talk a little bit more about your rationale on the portfolio overlap and cross-selling opportunities with that product and just areas you look to build out around it.

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

Yes. And if I could write a question and hand it to somebody, that would be the one I would hand you, Cecilia, because, thank you. I appreciate it. Brightwater, I think, does several things for the company. One of the fastest areas of the company's growth is our drainage catheters. I mean, it continues. And some of that is because of shortcomings of competitors but that business, I think, I want to look up the number, I think, year-to-date on that one for me, so I can give it to her, but it's growing rather nicely. With this product, it is a combination of a nephrostomy drainage catheter and urethral stent. And -- but what it does that's so exciting is that it is one procedure to place this versus 2 procedures in the hospital. There you go and have a drainage catheter put in and then you come back and you have to have the other product put in. And to give you an example, my FP&A guys are telling me that our drainage catheter business right now is growing at 35% year-to-date. Now this is, that's a big, big number for the company.

Anyway, back to the story. The -- we've got an order yesterday for 10, from a hospital in Texas, they're $1,500 a piece with about a 75% gross margin. So it's to our same customers. This is done by IR docs, and it moves Merit also not just into the drainage business, but also into the urethral stent business. But for patients, again, let me come back to patients. You go once, you go back in a doctor's office and in 10 minutes, you convert it from a combination to a urethral stent. Now we also have recently received the biliary indication approval, clearance, I think is the word my regulatory people like me to use, and there's thumbs up in the back of the room. Thank you, [Glenn]. And I -- there are no competitive products in that area. None. And so we are building. We have had our COO down in that facility. We're building product and inventory. We did training to our sales force about 2 weeks ago, and we think it's very, very exciting, not only from cross-selling but really a novel technology, patented technology. Again, in Europe, it does not have the CE Mark. It's going to probably take me, I hate to say this, I think, 2 years before I can get it approved there which just drives me nuts. That being said, in the United States and some other markets, we think it is a fabulous product, fabulous technology. And like our sales guys that I talked to this morning, because I call the sales guys that got that order. He said, "Fred, there's a lot of people that have drainage products. We're still growing dramatically." He said, "I had 5 doctors standing around me yesterday in another hospital just wanting to know about this product." From a reimbursement point of view, it saves money for the hospital and the health care system. And most importantly, you have a patient that goes in once, literally under local anesthetic versus 2 procedures that are local and general anesthetic. And you take a look at the suite time, the cath lab table time, it cuts it so that you don't have to use those for nonincome-producing, because when they put in, they only to get reimbursed presently for 1 procedure, not the 2. So that's a long story but we're very excited about the technology. It's again something that nobody else has. It will take time for us to build that out but it's an exciting product line for us.

Operator

(Operator Instructions) Our next question will come from Jayson Bedford of Raymond James.

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

So maybe just a couple, hopefully, quick ones. On the gross margin line, I think I understand the weights related to the incremental fluid management business. But I guess, the key question here is, what are you doing structurally to improve the gross margin on the business? Are there opportunities to consolidate manufacturing facilities? Are you implementing a little bit more discipline on price? What are you doing here to drive better gross margin?

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

Yes. Thank you. Thank you for that question. Before we came on to this call, we spent time in here, talking about this. We spent the last week analyzing and looking and talking about the business plans. We're going to continue to move product to Mexico. And the other thing that we've done, Jayson, and we recently worked out and looked at our product log and took a look at the higher-margin products and their contribution and the lower-margin products. And we are taking and looking at making sure that those that have higher cost in them are then put in the proper locations for manufacturing. We're taking a look at vendors. We're taking a look at the higher volumes we have and locations. We're setting forth strategies in terms of selling. Now some of the things that diecast, for instance, on the fluid management. But even in that particular situation, it's cavitation where you -- instead of having a 2 cavity, you might go to a 4 or an 8. Now, these will take time. The point I'm trying to make, in every aspect of this business, and I've got 40 people sitting in this room; we are sitting down, and everybody has their plans and the FP&A guys are going out and we're working diligently. We understand what you expect of us. But even more importantly, we understand what we expect of ourselves. We know that people are disappointed. We know -- I mean, we understand the gravity of this call.

And we're warriors. And as like one guy said to me, "Fred, I've known you for 20 years. And I understand the quarter but I have absolutely no concerns about your called action and the things that you guys have done when you've had to turn the ship." And so we are working diligently on efficiencies, locations. I'm looking at the products and see where we spend our time and how we incentivize the sales force. So this is a broad conversation in every aspect of travel, expenses. And while we're on that, for years, everybody talked about, and I tried to point it out but I do want people to look at the fact, and I hope we get some credit, for the fact that we maintained our expenses. Even though the revenues were lower, we still came in at the numbers. And had we made the number, which we did not, we would have been lower than those numbers. So I think on the discipline side of the operating expenses, we feel comfortable with that. But even with that said, every aspect of this business travel, trade shows, operations, every aspect of it, Jayson, we are laser focused. It doesn't happen overnight. But there are a lot of programs and initiatives going on in this company as we speak.

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

Okay. The new GPO contracts related to fluid management. I understand that they're dilutive to gross margin. But are the neutral to op margin.

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

No, we actually think that they'll increase our operating margin. As I mentioned earlier, it requires little effort on our part. Outside of the GPO fees that you would pay and maybe some commissions, it's really all leveraged.

Operator

Our next question will come from David Saxon with Needham & Company.

David Joshua Saxon ***Needham & Company, LLC, Research Division - Associate***

Two quick ones. I guess, one on free cash flow and the other on the guidance. Just wondering how big of a priority free cash flow is for you. And what kind of initiatives you guys have in place to try to improve it.

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

Yes. I'll just start by saying that -- and I'll let Raul will finish, that it's become more and more of a priority and we hear the message. I think you saw improvement between the first and second quarter, you'll continue to see improvement. And with that said, Raul, go ahead and weigh in.

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

Yes. No, I think we've started hearing a lot of focus on it late last year. As you know, we're long-term thinkers. We plan in advance. And so listening to kind of the feedback from investors that they wanted an improvement in free cash flow, obviously, that's going to require a little bit of effort on our part to kind of prioritize how we do our capital commitments that we've already set out and improving that cash flow. So I think one step that we took forward, we did talk about paying down our debt. We thought that was the right step forward, at least, to get some of the investors, something to kind of hang their head on, and we are on pace to pay the $40 million to $45 million there.

As we kind of look forward, we do expect an improvement in free cash flow. But it's going to take us a little bit of time just because of the nature of our planning. So hopefully, that helps.

David Joshua Saxon ***Needham & Company, LLC, Research Division - Associate***

Yes, yes, that's helpful. And for the EPS guidance. I mean, it looks like you took down EPS by $0.17 at the midpoint. Just wondering if you can break that out between the FX, Brightwater and, I guess, some of these other issues.

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

So there's $0.03 associated with Brightwater that we announced in -- when we made the announcement of the acquisition. And then on the -- on FX, it includes about $0.04 to $0.06, of which, $0.04, we already kind of went through, through the year through June.

David Joshua Saxon ***Needham & Company, LLC, Research Division - Associate***

Okay. And the rest is just kind of mix...

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

Yes. It's really just the mix on the margin.

Operator

And our next question will come from the line of Mike Petusky with Barrington Research.

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

A quick one for Raul and then a longer one, I guess, for Fred. Raul, did you say interest -- did you guide interest expense for the full year.

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

I didn't guide it but I did give you our interest cost. It's about 3.1% as of June. Now there's an anticipated rate cut, I guess, in the next month or so, within the next couple of weeks. So we'll see how it goes

David Joshua Saxon ***Needham & Company, LLC, Research Division - Associate***

Glad I asked that because that sort of got muddled as I was listening to it. Okay. Great. And then, Fred, I guess, you've been through these types of quarters before, and thanks for the last 4, 5 years there haven't been many, if any, of these types of quarters that you've been thrown before. Obviously, you've got the currency, you can't do anything about it. Some of the political noise, can't do anything about that. But as you look at sort of what is controllable on your end. I mean, are there 2 or 3 things where you'd say, "Damn it, we should have been better here. We should have been better here, and we wouldn't have quite hit the kind of wall that we hit here in Q2." I mean, were there aspects of this that where you guys just should have been better.

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

Yes, thanks, it's a good question. And it's like a baseball game, you're out there -- I went to one last night, it was a state holiday here. The local team was up 3 to 2, and they lost 10 to 3. What happens is there were a couple of pop flies -- there was one, and they dropped the ball. Those sorts of things. I think as we look at it right now, I think the expense side -- I mean, we've been cognizant of this and something we said we can't let these get out of control. I think on the selling side, I don't want to kind of put blame on anybody. It's the company, it's me, I'm responsible for it. There were some delays for instance. We had a number of products that because of the demand in the Middle East, we were not able to ship a lot of products that are going to be in the third quarter because we got the orders late. It wasn't that we couldn't respond, it's that we got them late. So -- and then we shipped some of them. But then you get the point of sale, and you have to back some of those things out. I think there was -- it's kind of funny, because again, you go again to FX. There's mix in the selling. Go ahead, Raul.

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

No, I think as we look at -- as we were looking at the financials. I mean, some of the -- a lot of the things that we can control, we feel like we did a pretty good job of controlling those. The mix -- our sales force, they're incentivized to sell certain products -- skewed towards higher-margin products. But at the end of the day, our customers drive somewhat what that margin -- or what products they decide to buy. I will say that we didn't see a pricing issue outside of Aspira. This wasn't a pricing issue. It was simply just the demand in our products for our legacy products was just outweighed our higher gross margin products. So I mean, I think, maybe look at --

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

And again, one of the other things, too, Mike. I think what caught up with us a bit is, we did a lot of transactions last year. I mean, we had the BD, that was enormous. I mean, from a price point of view, it wasn't a big deal. I mean, when I say that, I think we bought it right. That's what I mean. But in terms of the magnitude of the transaction of moving things from 6 facilities into 1 and being handcuffed to some effect, both in terms of a regulatory and expanding beyond that were things that were new to us. We've never done a forced divestiture from 6 facilities that we had to deal with. It absorbed a lot of resources.

Now that being said, that's coming to an end. And so I think to the point that we were maybe -- I don't -- I don't like the word naive but I don't like unprepared because our guys have done a great job. I don't know that we understood the impact both on our sales force and how much it absorbed. And in the meantime, we ended up doing the ClariVein and we ended up doing Cianna. I think we're happy with all of those transactions.

The burden that it put on the company and the sales force, to kind of be able to absorb all of that, even though we kept the Cianna people; but to put all of these things together and manage it, we probably underestimated the effect that, that would have on revenues. I'll give you an example.

I would -- one of the things we've recently done. Is we've -- again, we're looking at the -- who sells our products. And what I mean, our sales force. And the biopsy product line, the drainage catheters, and then you throw onto it the Brightwater. In talking to a salesperson this morning, who I called, and I do this often, because I like to do it, and I like to talk to my troops. He said, "Fred, I want to just thank you guys for making some of these adjustments because I have too many products in my bag. And now I'm able to spend time on these products." And he was able to go out and get 2 new accounts on a product that we like that he didn't have time to sell before. So I think that in looking at it -- and one of the things we've talked about, we want to kind of think is keep things steady into the product groups. Not that we might not make an acquisition, we might. But we, I think, are wiser in how we manage it, where we put it, in very candidly, all the products. So I think we are going to be a little bit in the absorption point, just absorb these things. And I think those affected us.

Now that being said, I wouldn't change anything in terms of the decisions. But I think it put a lot of heat on Mexico, on our operations team. And consequently, it affected the sales force and our ability to get them trained, get them to meet with customers because of all of the things they have to pick up. I mean, the -- back to Dickinson something, we picked up 100% of that. So anyway, I think there are always lessons earned -- learned, Mike, and I think, and lessons earned as well. So that's a long answer. I hope you don't feel it's rhetorical. Because I mean all of us that are sitting in this room, all believe that we wish we'd have done this a little bit better. We wish we would have considered that. But remember, it's a 7-game series or it's a full year. I mean it sincerely, when we all look at this, we think this is a very short-term situation, and that we will -- we will be back very, very quickly because we need to be and we want to be. We are not discouraged. We might be tomorrow morning, for about 10 minutes, and once we get through that, we won't be at all. And we'll be back. We always have been and we will continue to be.

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

Okay, fair enough. Just one more question. So obviously, gross margin has been a big topic on this call, and mix is being blamed for not only some weakness there, but just in general, in terms of the soft guide going forward. Is there any need to sort of look at how sales have compensated and incent the sale of higher-margin products. Is there a need to sort of reexamine that issue?

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

Yes, we do that already. But Mike, things always need to be reexamined. We were doing this earlier this afternoon. I'm saying, "Okay, this is what makes us money. These are the things that don't, how -- what are the plans going forward? What are the market conditions? What are our customer needs?" Often times, it just can't be about you, you have to weigh have a lot of factors here as you make those decisions. But the answer is insight and evaluation and taking inventory is always something that a business ought to be doing. But on the inside of the coin, in fairness, I think to us, look, we grew the core business at 8% to 10%. We were able to keep the SG&A expenses in line. We have new products coming out. We were able to absorb the growth and the various things, maybe not as well as we should have. But here we are, we're approaching $1 billion. And I think this is a great opportunity for -- I was talking to one guy and said, he sent me a note, he said, "I will be smiling in dollar, dialing tomorrow, you said it was too expensive but here's your entry point. We'll see what you guys say and how The Street responds." But we're not going to give up and we're not going to stop. So go do your jobs, do the things that you need to do, do it as well as you can but be assured that you have not heard the last story for Merit Medical. We'll be here, and everybody in this room is committed to -- this will be just another chapter. I think you said it, these things happen from time to time. Look at Amazon today, look at these guys and those guys. Look at Boeing, those are great companies. And every once in a while you stub your toe. And okay, we stubbed our toe, we admit it. We are -- we recognize it. And I think that's the first step of making sure that we will continue. So thank you. I don't mean to get -- I'm not angry. I am fired up. And I'm done, unless you want to ask me more questions, Mike.

Operator

Thank you. And I'm showing no further questions. I would now hand the conference back over to Fred Lampropoulos, Chairman and Chief Executive Officer, for any closing comments or remarks.

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

Well, first of all, to our administrator, thanks for saying my name correctly twice. I appreciate that. Ladies and gentlemen, thank you. This -- we were on here for an hour. There were a lot of questions asked. I think I have made my statement. Raul has, the staff has. We may have dropped the ball, okay, but we're still in this ball game. And we're going to keep playing and it's going to be -- this is a great business, and we'll continue to do so and we will improve. And wishing -- and I think that's the last thing I'd like to say today, best wishes. Thank you very much. Raul and I will be around for several hours taking questions and clarifying issues to the proper legal extent that we can.

That being said, we wish you well. Good evening and thank you from Salt Lake City. Goodnight.

Operator

Ladies and gentlemen, thank you for your participation on today's conference. This does conclude our program, and we may all disconnect. Everybody, have a wonderful day.