Disclaimer

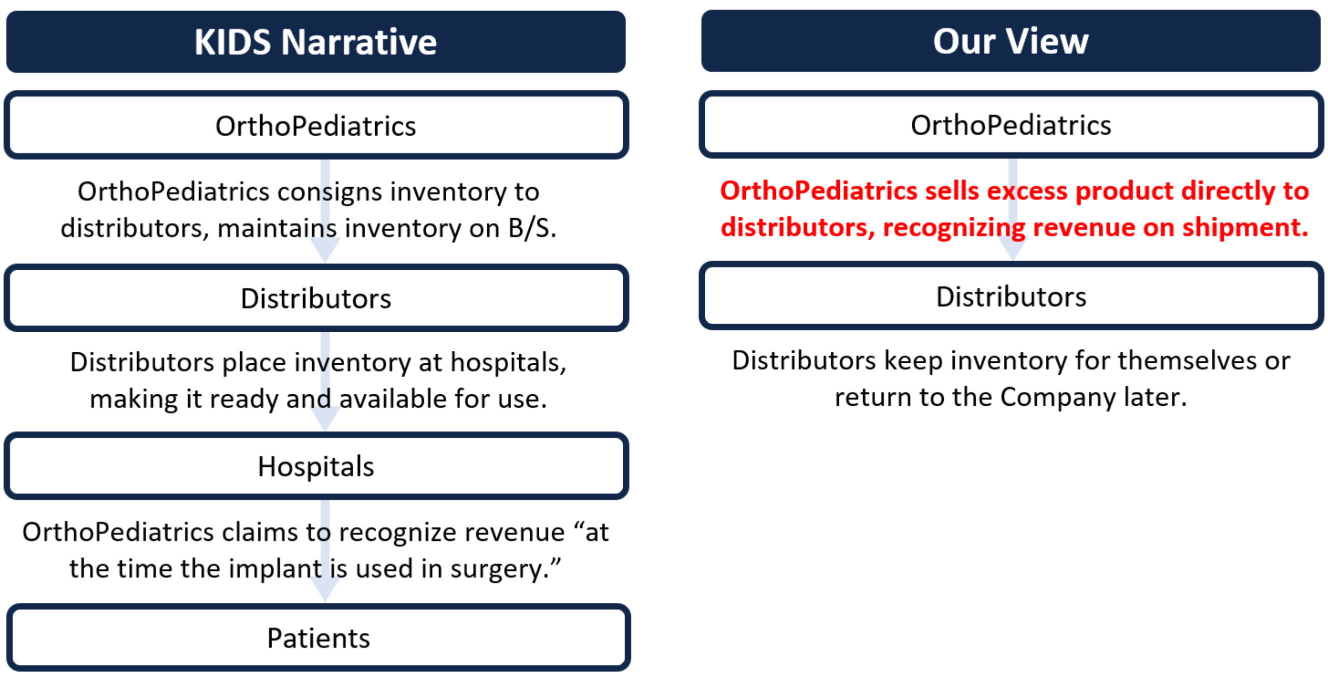
OrthoPediatrics Corp. (KIDS): Pleading the Fifth

We published our original report on OrthoPediatrics Corp. ("OrthoPediatrics", "KIDS", "the Company") on December 2, 2020. In it, we detailed our view that the Company has engaged in a channel stuffing scheme that has systematically and significantly overstated revenues. Instead of addressing our report head-on, the Company has apparently opted to hide behind a sycophantic sell-side analyst, Needham's Mike Matson, who slapped together a response to our original report on December 3, 2020.

As noted in our tweets, Matson's primary error is that he glosses over the Company's own vague language which allows for revenue recognition upon product shipment (emphasis ours):

> "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 customers, 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."

Matson then boldly claims that "This in no way would allow for the sale of excess products or channel stuffing", suggesting that he's missed the boat entirely. We've already explained exactly how we believe that channel stuffing is occurring, as recognizing revenue upon shipment could occur both when (a) replacement product is shipped after surgery, and also (b) when excess product is shipped to distributors. See from our original report:



Matson seems intent not on discovering what is truly happening at OrthoPediatrics, but simply on parroting the Company line, putting on a brave face to reassure investors that "We have confirmed with management that this means sales through these agencies to hospitals as opposed to sales to these agencies."

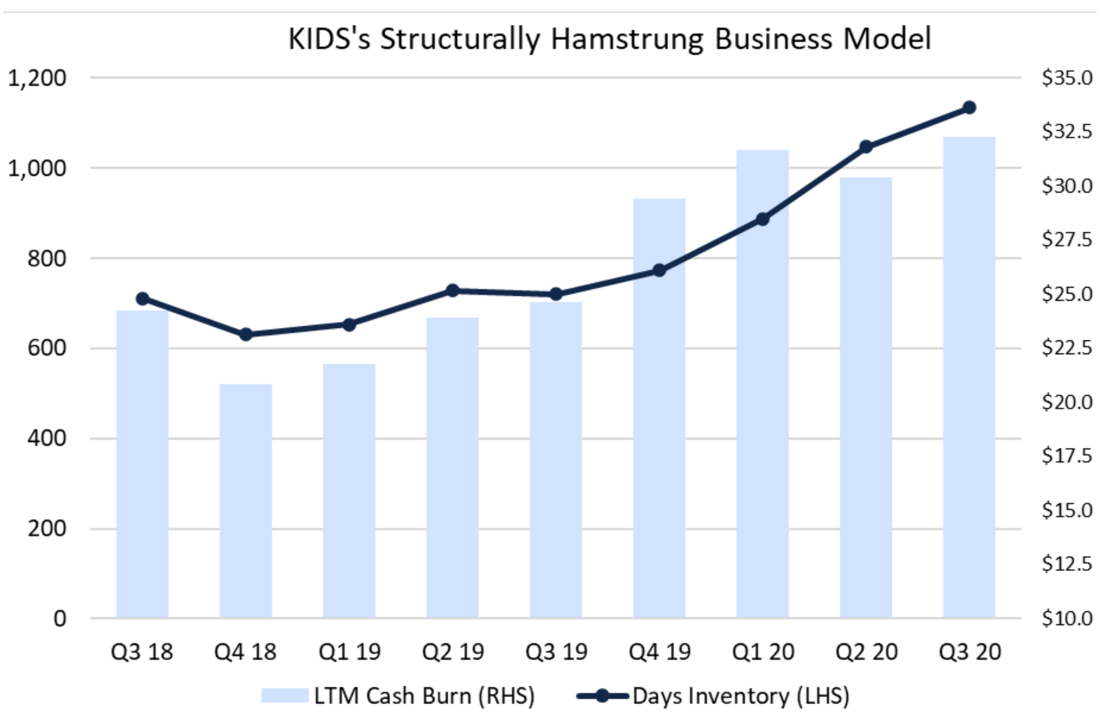
Matson and the Company leave the elephant in the room unaddressed: Why have multiple OrthoPediatrics distributors with whom we spoke stated that the Company offers incentives for direct inventory purchases? We believe the implication is bad enough that Matson and the Company would rather not address it. We also don't believe the Company's claim – apparently made only through Matson – to have sold just $440,000 worth of product directly to distributors over the past 8 years, given that a single distributor practically bragged to us about the "probably a quarter million dollars of inventory" that he alone had purchased. Multiple other sources also characterized direct distributor purchases as a regular practice. All it would take for Matson is a few calls to distributors, but he appears incapable of the Herculean task of picking up the phone.

Matson's defense of the Company's employees forming distributors is similarly disappointing, as he again regurgitates the Company's line that "KIDS did have around 10 direct reps in 2015 but transitioned these to independent agents in 2016." However, he misses the mark entirely, as our report clearly showed that ex-employees continue to carve out distributorships:

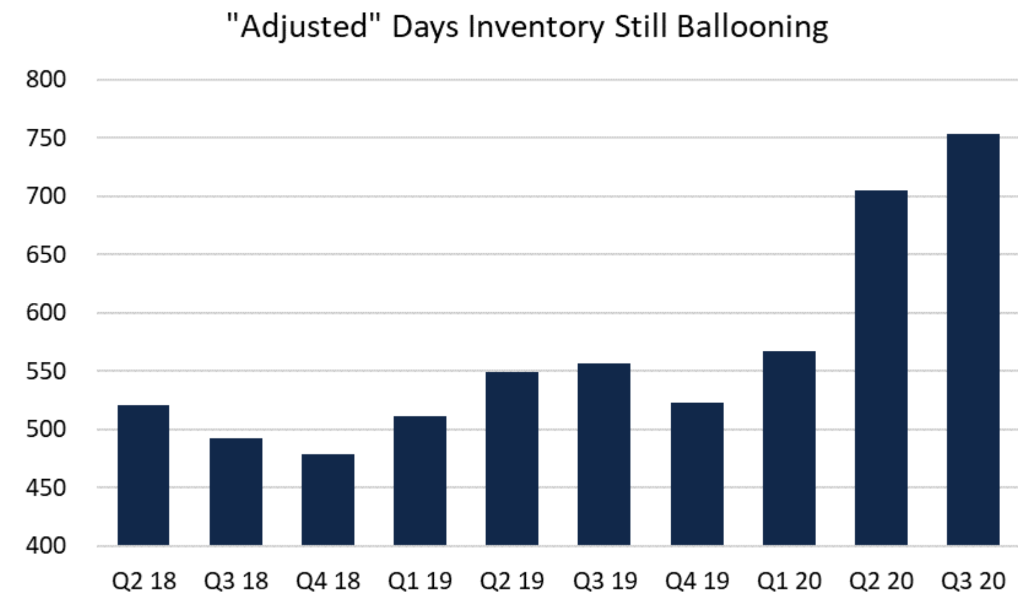
Name	Former KIDS Role	Until	Name of Current Distributorship
Dan Brault	Sales Representative	Jun-20	Upstate Surgical Supply Corp
Mary Kate Rosenfelder	Sales Representative	Jan-20	RoseMed, LLC
Melanie Arnold	Medical Device Sales	Mar-16	MK Medical, LLC
Mark Phillips	Sales Vice President	Dec-15	Pediatric Device Solutions LLC
David Steinberg	Product Specialist	May-15	Core Medical Device Distributors Corp
Jessi Prahl Asmundson	Sales Specialist	Aug-12	EAV Medical Corp

Matson also contorts himself into framing the Company's bloated inventory position as a signal of growth rather than a function of its structurally hamstrung business model, stating that "We actually think KIDS inventory levels are bullish since we believe that it indicates management's confidence in KIDS growth prospects."

As detailed in our original report, we believe OrthoPediatrics' own financials demonstrate that the Company has converted consigned inventory to revenues at a slower and slower pace:



Even if we were to redefine the definition of inventory days so as to measure historical inventory levels against the Company's next twelve month revenues rather than its past twelve month revenues, days inventory continue to balloon. In our view, these figures are hardly reflective of "bullish growth prospects", just a horrible business:



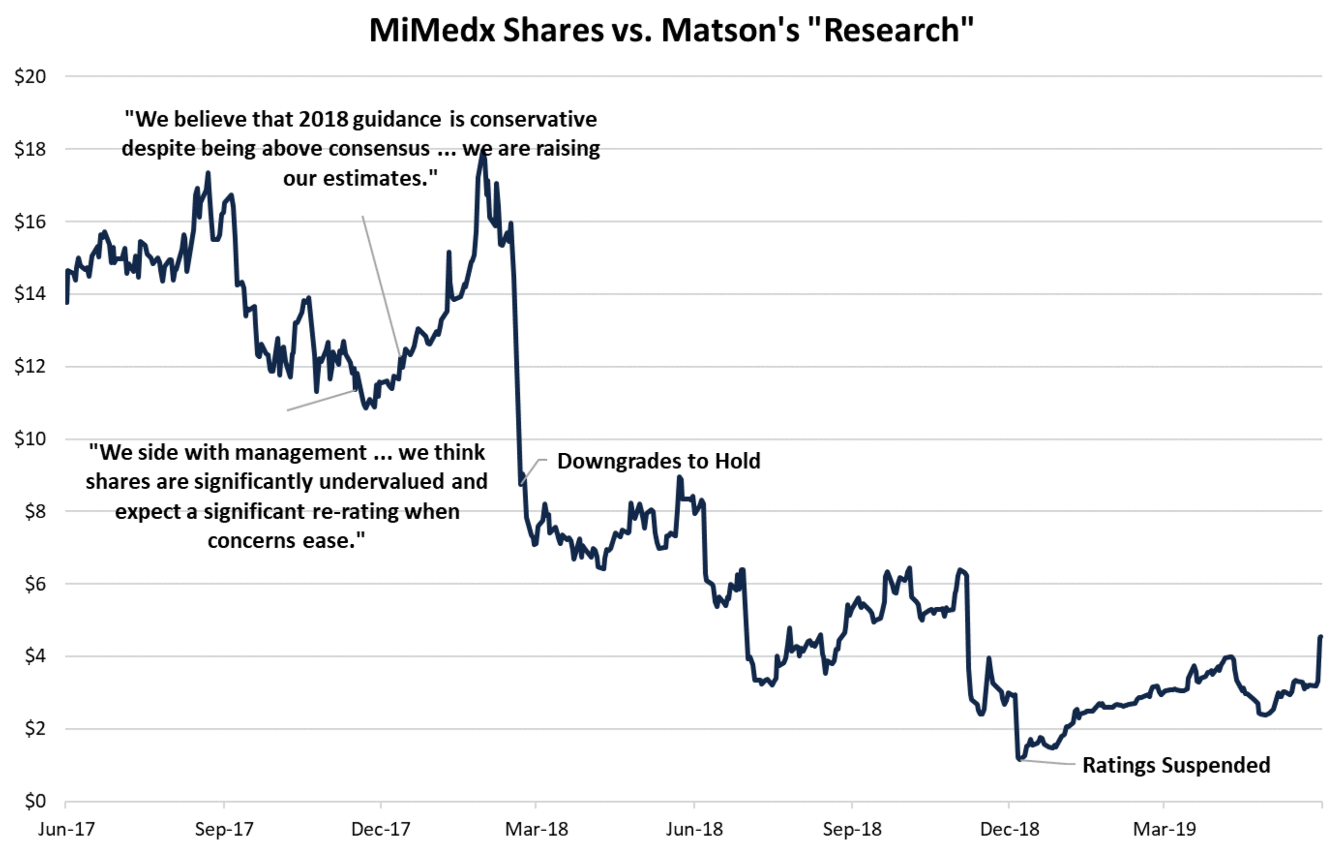
We understand Matson has embraced this role of willfully ignorant management mouthpiece just as he did for MiMedx Group, Inc. (MDXG), whose former executives were charged with fraud in November 2020. See Matson explicitly stating he "sides with management" as he called MDXG shares "significantly undervalued" while they traded at $12.12 on November 14, 2017:

> **Controversy around short reports may continue to weigh on MDXG shares in the near term.** We think that there is a somewhat binary outcome around the short report allegations and SEC subpoena. In our view, MDXG shares are either moving much higher if the allegations and investigation turn into nothing or much lower if significant issues are uncovered. We side with management and expect the former but acknowledge that this is a high-risk, high-reward situation. We think shares are significantly undervalued and expect a significant re-rating when the concerns ease. While we can't predict when or how this will happen, we think the move could be sudden and easily missed.

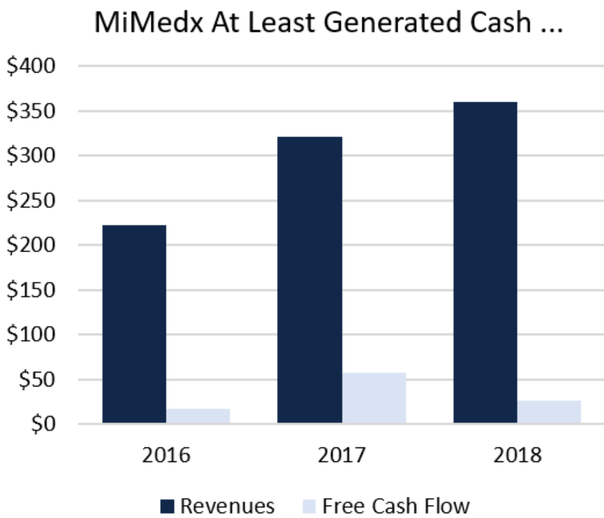
Further, on December 13, 2017, with shares trading at $12.25, Matson raised his guidance even as he acknowledged already being at the high end of Wall Street consensus:

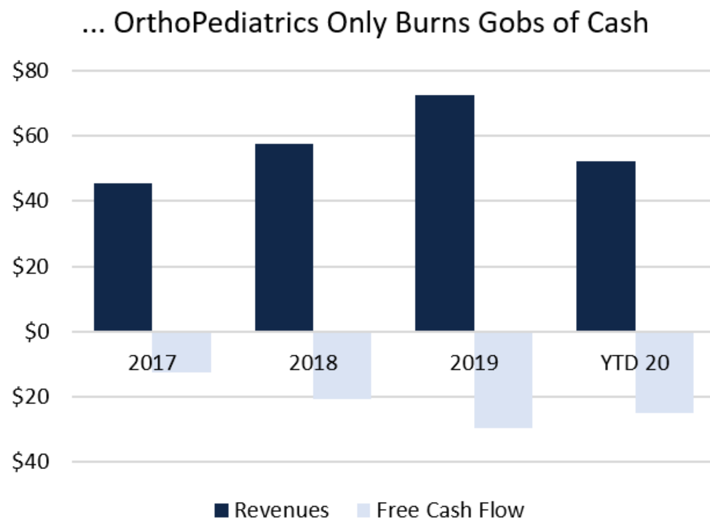
> **We believe that 2018 guidance is conservative despite being above consensus.** MDXG's 2018 revenue guidance implies 22-23% organic revenue growth (after adjusting for the Stability divestiture). We note that MDXG previously announced that they would be above their 4Q17 revenue guidance range and therefore their 2017 guidance range. Given this, we believe that 2018 revenue guidance is conservative given the potential for: 1) expanded EpiFix VLU insurance coverage, 2) increased out-of-pocket sales of AmnioFix Injectable given the plantar fasciitis data, 3) MDXG's sales hires to exceed its stated target of 60, and 4) international sales to contribute more than expected.
>
> **We are raising our estimates.** We are raising our 2018E and 2019E revenue estimate to $384M from $374M and to $440M from $427M, respectively. And we are raising our 2018E and 2019E adjusted EPS estimate to $0.45 from $0.40 and to $0.55 from $0.49, respectively.

Three months later on February 20, 2018, MiMedx postponed its fourth quarter and full-year financials in order to conduct an internal accounting investigation. Shares closed down 39.5% the next trading day, to $8.75. Shares have yet to fully recover even to those price levels, let alone come close to Matson's "Strong Buy" $21 price target:



We think the situation at OrthoPediatrics is worse than it was at MiMedx. On March 17, 2020, MiMedx filed its 2018 annual report including restated financials for 2016. In it, MiMedx disclosed that it generated $359 million in 2018 revenues, and from 2016 through 2018, generated a cumulative $101.8 million in free cash flow. On the other hand, from 2017 to today, OrthoPediatrics has burned $87.5 million in cash:





We continue to believe that OrthoPediatrics is a structurally broken business which has relied on nefarious tactics to inflate its reported revenues, and we remain short the Company. **<u>We reiterate 5 questions for the Company:</u>**

1. What is the dollar value of inventory purchase directly by distributors in each of the past 5 years?

2. How many distributors have been issued equity-based compensation/awards over the past 5 years?

3. How many shares has the Company effectively issued to distributors over each of the past 5 years?

4. Has OrthoPediatrics ever offered a distributor (a) equity-based awards, (b) the option to return product, and/or (c) increased commission schedules in exchange for direct product purchases?

5. Management has repeatedly stated that the acquisition of Orthex would improve the Company's capital efficiency. Why do inventory balances and cash burn continue to balloon?

We think if management continues to decline to answer these questions directly, investors have all the information that they need to know about the Company.