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OrthoPediatics Corp. (KIDS): Even Channel Stuffing Can't Save This Company

We are short OrthoPediatics Corp. (“KIDS”, “the Company”). We believe OrthoPediatics has engaged in a channel stuffing scheme that has systematically and significantly overstated revenues.

OrthoPediatics sells products used in pediatric orthopedic surgeries. The Company claims to consign inventory to its distributors and recognize revenues “when products are used in procedures.” However, this vague language disguises that the Company books revenues upon shipment of replacement products that restore consigned sets to full capacity. We believe that the Company has abused its ability to book revenues upon shipment by selling and shipping excess product directly to its distributors, many of whom are exclusive to the Company. We conducted 6 interviews with 4 Company distributors and 2 former Company executives, each of whom exposed the mechanics of this scheme, wherein distributors have been induced to buy excess product directly from the Company in exchange for (a) equity-based awards, (b) the opportunity to return product, and/or (c) product discounts or increased commission schedules.

Against this backdrop, we find it concerning that many of the Company’s “exclusive distributors” are simply former OrthoPediatics employees who have formed their own distributorships, often while still employed at the Company. We profile 6 such distributorships, as well as another distributor whose employees retain OrthoPediatics email addresses. We view these relationships to be highly concerning, as they give the Company the ability to recognize revenues by stuffing inventory at crony “third party” distributors. To us, such practices mirror those that we’ve witnessed at companies such as ArthroCare, MiMedx, and Valeant Pharmaceuticals. Four ArthroCare executives were sentenced to prison, while MiMedx’s CEO and COO were found guilty of securities and accounting fraud less than 2 weeks ago.

We find it telling that OrthoPediatics CEO Fred Hite previously served as CFO at Symmetry Medical, whose U.K. subsidiary was charged by the SEC for “improperly and prematurely recognizing revenue, improperly capitalizing expenses, overvaluing inventory, and understating costs of goods sold.” Hite paid a fine and forfeited his associated bonuses. Moreover, while he was never charged, OrthoPediatics Senior Managing Director Mike Pritchard joined the Company directly after having worked for ArthroCare during the fraudulent period.

We also believe OrthoPediatics is structurally broken, and management has already lied to investors about the Company’s slowing growth.

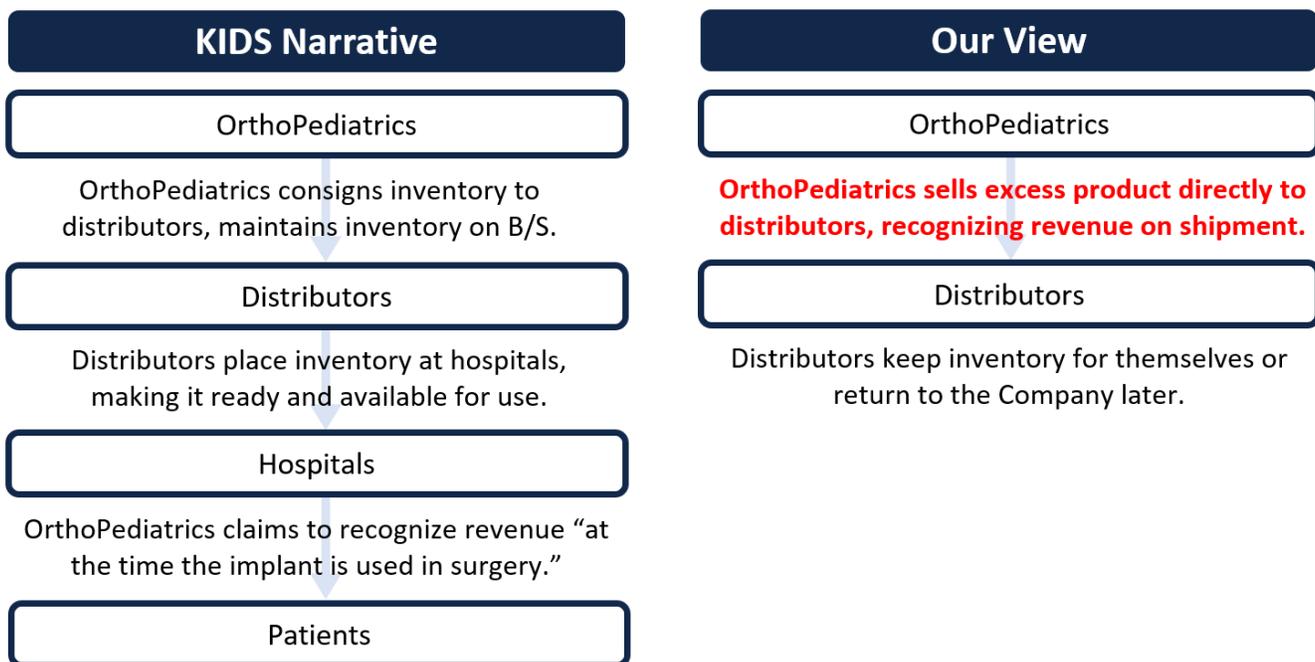
In December 2019, CEO Mark Throdahl stated that “growth is steady with or without Orthex [the acquired business],” yet we estimate using the Company’s own disclosures that OrthoPediatics grew just 11.7% organically in 2019, well short of both its highly-touted “consistent 20% plus growth rate,” and its 2019 revenue guide. Moreover, after OrthoPediatics owned Orthex for nearly 7 months, hence allowing the Company to meet its guidance, it then sold a portion of Orthex back to Squadron Capital, in our view a highly-conflicted related party.

OrthoPediatics holds 1,135 days of inventory, which has more than doubled over the past 3 years, while peers hold just 341 days, on average. We view these bloated levels as a function of the Company’s structurally hamstrung, capital-incinerating business model. Thus, OrthoPediatics has also turned to M&A and a “Loaner Program,” yet we view both as futile attempts to grow the flailing business as cash burn continues to worsen.

OrthoPediatics CEO Throdahl once characterized the business as “needing to be on a treadmill to oblivion” and we couldn’t agree more. Yet at \$45 per share, investors now pay over 11x revenues for this elaborate scheme. Given what we believe are highly unsavory business practices at OrthoPediatics, we are short.

KIDS Recognizes Revenue on Replacement Shipment, Not Strictly on “Use in Surgery”

In order to understand the manner in which we believe OrthoPediatics has been artificially inflating revenues by shipping excess product directly to distributors, readers must understand how product moves between the Company, its distributors, hospitals, and patients. When an orthopedic surgeon treats a patient, he or she often does not know in advance which implants and instruments will be necessary. As such, OrthoPediatics consigns an entire “set” of products either to a distributor or a hospital, where the products remain readily available as needed. **When a surgeon uses product, a purchase order is then created not for the consigned product used, but for the replacement product which restores the consigned set to full capacity. OrthoPediatics then recognizes revenue when this replacement product is shipped by the Company.** We believe that OrthoPediatics has exploited this veiled policy allowing revenue recognition upon shipment to artificially inflate revenues by selling and shipping excess product directly to distributors:



We Believe KIDS Has Stuffed the Channel by Inducing Distributors to Purchase Product

We interviewed 6 individuals who stated that distributors often buy product directly from the Company at the Company’s request, and that the Company often offers distributors (a) equity-based awards, (b) the opportunity to return product, and/or (c) increased commission schedules effectively in exchange for these orders:

Source	Described Direct Distributor Purchases	Described Distributor Inducements
Distributor #1	✓	✓
Distributor #2	✓	X
Distributor #3	✓	✓

Distributor #4	✓	X
Former Executive #1	✓	✓
Former Executive #2	✓	✓

We think the scheme at OrthoPediatics results from the constant pressure to meet its highly-touted “consistent 20% plus” revenue growth which underpins its valuation at over 11x revenues. In the words of Distributor #1, OrthoPediatics “asks you to take it [inventory] off their books and they’ll remunerate you in different ways.” The first of these “different ways” includes opportunities to re-sell product or return product to the Company, as confirmed by two different distributors we spoke with:

Source	Comments
Company Distributor #1	“...If you bought something and didn’t use it then they’d [OrthoPediatics] look for an O.U.S. [international] distributor to take it ...”
Company Distributor #2	“...if we didn't meet our quota for one month then the distributor bought inventory almost to meet his quota, and then would resell it at a negotiated price.”

Two current Company distributors and another former Company executive also stated that the Company offers equity-based awards or increased commissions:

Source	Comments
Company Distributor #1	“I say [to OrthoPediatics] can you give me any sort of increased commission potential ... it can be 50% commissions for the next 6 or 12 months.”
Company Distributor #3	<p>“When I was 27, I joined and invested it was my life savings at the time to invest in OrthoPediatics ... I’m still a shareholder.”</p> <p>“They have awarded equity [to distributors] for performance. Distributor of the year in the past has gotten equity awards ... That’s been the soapbox that I’ve stood on: If you want the distributors to increase [inventory] turns, they’re more likely to jump off the couch on a weekend to get product out if they’re invested in the company too ... I’ve seen the incentive of our team with the equity awards and the changes that have taken place since they’ve given awards.”</p>
Former Company Executive #1	“Distributors get 250 shares each, then 50 or 100 shares for each rep. Absolutely [OrthoPediatics] pays distributors RSUs ... All of the distributors have shares, and continue to get shares.”

In every one of our conversations, each source characterized these practices as frequent and pervasive in nature, as if commonplace. As such, we believe these practices have become structural to the Company’s credo:

Source	Comments
Company Distributor #1	"This happens [KIDS offers direct purchases] to 100% of people [distributors] ... There were three or four times when I bought [inventory]."
Company Distributor #2	"I've been over to my old boss's house before, and he would have tons of just back stock inventory, drill bits, screwdriver shafts. Sometimes my old boss would bill for screwdriver shafts on every surgery case, which shouldn't be because they're reusable. They're not single disposable screwdriver shafts at \$840 apiece. He was billing for them. They weren't being completely replaced. He ended up with a big stash of back order inventory, extra inventory."
Company Distributor #3	"Yeah actually I've probably got a quarter million dollars of inventory that I own ... I'd say there's probably a few others [distributors] that have done that [purchased product directly from the Company] as well."
Company Distributor #4	"That happens [OrthoPediatics asks distributors to order product] all the time. There are times where I come to them but most of the time it's the other way."
Former Company Executive #1	"Greg Odle made a call to distributors to ask them to buy product to make sales [projections / quotas]. So, what happened was the distributor cut a check to OrthoPediatics to buy full sets ... In my footprint, that happened to two people that I know of, and they weren't even larger players ... We were quite a bit short [on revenues] going into [quarter end] ... I can only assume that everyone [all distributors] got that call."
Former Company Executive #2	"There are times when they [OrthoPediatics] will sell entire sets to distributors. Among larger distributors, that's becoming more frequent... In the Northeast, in Los Angeles ... The fellow in Missouri..."

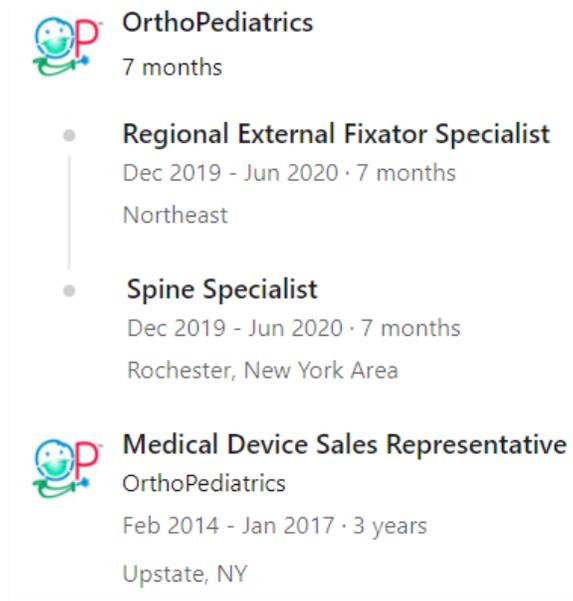
OrthoPediatics Sales Reps Form Their Own Distributors While Still Employed at KIDS

Given that the Company pawns excess inventory off to distributors, we find it highly concerning that many OrthoPediatics distributors have been employed directly by the Company, and have even formed these distributorships while still claiming to be employed by the Company. We summarize and profile 6 of these below:

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 Prah Asmundson	Sales Specialist	Aug-12	EAV Medical Corp

Dan Brault – Upstate Surgical Supply Corp

Dan Brault joined OrthoPediatrics as a Sales Representative in February 2014 and remained with the Company until June 2020, per his [LinkedIn profile](#):



However, in February 2015, well after he purports to have joined OrthoPediatrics, Brault registered “Upstate Surgical Supply Corp”, which is tied to another OrthoPediatrics distributor by way of a common Registered Agent:

Selected Entity Status Information	Selected Entity Status Information
<p>Current Entity Name: UPSTATE SURGICAL SUPPLY CORP. DOS ID #: 4717438 Initial DOS Filing Date: FEBRUARY 27, 2015 County: MONROE Jurisdiction: NEW YORK Entity Type: DOMESTIC BUSINESS CORPORATION Current Entity Status: INACTIVE - Dissolution (Nov 13, 2018)</p>	<p>Current Entity Name: TRAUMA-RECON CORP. DOS ID #: 3202151 Initial DOS Filing Date: MAY 09, 2005 County: DUTCHESS Jurisdiction: NEW YORK Entity Type: DOMESTIC BUSINESS CORPORATION Current Entity Status: ACTIVE</p>
Selected Entity Address Information	Selected Entity Address Information
<p>DOS Process (Address to which DOS will mail process if accepted on behalf of the entity) DANIEL BRAULT 38 THORNTREE CIR PENFIELD, NEW YORK, 14526 Chief Executive Officer DANIEL BRAULT 38 THORNTREE CIR PENFIELD, NEW YORK, 14526 Principal Executive Office UPSTATE SURGICAL SUPPLY CORP. 38 THORNTREE CIR PENFIELD, NEW YORK, 14526 Registered Agent SPIEGEL & UTRERA PA PC 1 MAIDEN LANE 5TH FL NEW YORK, NEW YORK, 10038</p>	<p>DOS Process (Address to which DOS will mail process if accepted on behalf of the entity) TRAUMA-RECON CORP. 45 JOHN STREET, SUITE 711 NEW YORK, NEW YORK, 10038 Chief Executive Officer TIMOTHY HINSPETER PO BOX 483 MONTGOMERY, NEW YORK, 12549 Principal Executive Office TRAUMA-RECON CORP. 3 HASKIN COURT MONTGOMERY, NEW YORK, 12549 Registered Agent SPIEGEL & UTRERA, P.A., P.C. 45 JOHN STREET, SUITE 711 NEW YORK, NEW YORK, 10038</p>

As shown in the side-by-side above, Upstate Surgical's registered agent is Spiegel & Utrera PA PC, based in New York City. This same registered agent was used by [Trauma-Recon Corp](#), a separate OrthoPediatrics distributor. We also wonder how Dan Brault also operates Upstate Surgical Supply Corp out of New York, given that Trauma-Recon claims to be the Northeast's exclusive distributor of OrthoPediatrics. **This apparent web of multi-layered distributorships is never spoken of by OrthoPediatrics.**

Mary Kate Rosenfelder – RoseMed, LLC

Mary Kate Rosenfelder was [employed by OrthoPediatrics](#) as a Sales Representative from August 2017 to January 2020, at which point she became a distributor for the Company, registering RoseMed, LLC:

 <p>Mary Kate Rosenfelder President at RoseMed, LLC (OrthoPediatrics Distributor)</p>	<p>File Number 08431949</p> <p>Entity Name ROSEMED LLC</p> <p>Status ACTIVE</p>
 <p>OrthoPediatrics 3 yrs 4 mos</p> <p>Distributor Full-time Jan 2020 – Present · 11 mos Chicago, Illinois, United States Trauma and Deformity</p> <p>Pediatric Orthopedic Sales Representative Aug 2017 – Present · 3 yrs 4 mos Greater Chicago Area OrthoPediatrics: Spine, Trauma and Deformity</p>	<p>Entity Information</p> <p>Principal Office 26 POOLE CT. BATAVIA, IL 605100000</p> <p>Entity Type LLC</p> <p>Type of LLC Domestic</p> <p>Organization/Admission Date Tuesday, 28 January 2020</p> <p>Jurisdiction IL</p> <p>Duration PERPETUAL</p>

Again, we see that RoseMed's principal office is at a [5-bedroom home](#), 26 Poole Ct, Batavia, IL, a suburb of Chicago which appears to be her parents' home, even as Rosenfelder's address is listed in Chicago:

Managers	
Name	ROSENFELDER, MARY KATE
Address	1155 W. MADISON ST., APT 505 CHICAGO, IL 606070000

Melanie Arnold – MK Medical, LLC

Melanie Arnold is another OrthoPediatrics employee who has registered a distributorship concurrent to her employment. Per her LinkedIn, she has worked in sales for OrthoPediatrics since June 2010, yet in early 2016, she formed MK Medical, LLC, now a distributor of OrthoPediatrics product:

 Melanie Arnold President at MK Medical, LLC (OrthoPediatics Distributor)	Organization Number 0944263 Name MK Medical, LLC Profit or Non-Profit P - Profit Company Type KLC - Kentucky Limited Liability Company Status A - Active Standing G - Good State KY Country USA
	File Date 2/14/2016 5:13:44 PM Organization Date 2/14/2016 Last Annual Report 3/23/2020 Principal Office 6414 PASSIONFLOWER DRIVE PROSPECT PROSPECT, KY 40059 Managed By Members Registered Agent MELANIE ARNOLD 6414 PASSIONFLOWER DRIVE PROSPECT, KY 40059
 Distributor, Representing OrthoPediatics MK Medical, LLC Mar 2016 – Present : 4 yrs 7 mos Louisville, Kentucky Area	
 Medical Device Sales/Pediatric Surgical Orthopaedics OrthoPediatics Jun 2010 – Present : 10 yrs 4 mos Kentucky, Cincinnati Area	

As shown above, MK Medical's registered principal office is 6414 Passionflower Drive, Prospect KY 40059, which is a 4-bedroom, 4-bathroom home, according to [Zillow](#).

Mark Phillips – Pediatric Device Solutions, LLC

Next we have Pediatric Device Solutions LLC, run by Mark Phillips, who, [per his LinkedIn](#), previously served as VP of Sales for OrthoPediatics from October 2013 to December 2015. Pediatric Device Solutions, LLC was formed in November 2015, just prior to his apparent departure:

Secretary of State P.O. Box 13697 Austin, TX 78711-3697 FAX: 512/463-5709 Filing Fee: \$300		Filed in the Office of the Secretary of State of Texas Filing #: 802338105 11/25/2015 Document #: 642163070004 Image Generated Electronically for Web Filing
Certificate of Formation Limited Liability Company		
Article 1 - Entity Name and Type		
The filing entity being formed is a limited liability company. The name of the entity is:		
Pediatric Device Solutions, LLC		
<input checked="" type="checkbox"/> B. The limited liability company will not have managers. Management of the company is reserved to the members. The names and addresses of the governing persons are set forth below:		
Managing Member 1: Mark Allen Phillips Title: Managing Member		
Address: 1913 Desoto Drive McKinney TX, USA 75070		

As shown with MK Medical, Pediatric Device Solutions lists a residential address as its headquarters: 1913 Desoto Drive, McKinney TX 75070, a [3 bedroom condo](#). OrthoPediatics also [solicits resumes](#) from Facebook on Phillips's behalf, while Phillips retains a Company email address:



Our Distributor Mark Phillips is hiring in Jackson, Mississippi! Submit your resume to careers@orthopediatrics.com to be considered! Join our cause of helping KIDS!

Mark Phillips

214-497-2533

mphillips@orthopediatrics.com

David Steinberg – Core Medical Device Distributors Corp

David Steinberg is another former OrthoPediatics employee who now runs a distributor, [Core Medical Device Distributors Corp](#). Once again, Core Medical is registered to a [residential address](#), a 5 bedroom Tampa home:

2020 FLORIDA PROFIT CORPORATION ANNUAL REPORT

DOCUMENT# P15000040097

Entity Name: CORE MEDICAL DEVICE DISTRIBUTORS CORP.

Current Principal Place of Business:

10103 NEWHAM WAY
TAMPA PALMS FL 33647

Current Mailing Address:

10103 NEWHAM WAY
TAMPA PALMS FL 33647 US

FEI Number: 47-3922051

Name and Address of Current Registered Agent:

STEINBERG, DAVID
10103 NEWHAM WAY
TAMPA PALMS FL 33647 US



Jessi Pahl Asmundson – EAV Medical

Jessi Pahl Asmundson was a Sales Specialist with OrthoPediatics until April 2012, per [her LinkedIn](#). Presently, she runs EAV Medical in Atlanta, again out of her apparent [home](#) at 124 Sisson Ave NE, Atlanta GA:

Business Name:	EAV MEDICAL CORP.
Business Type:	Domestic Profit Corporation
Business Purpose:	NONE
Principal Office Address:	124 Sisson AVE NE, Atlanta, GA, 30317, USA
State of Formation:	Georgia
<hr/>	
Registered Agent Name:	Jessi Asmundson
Physical Address:	441 Park Ave SE, Atlanta, GA, 30312, USA
County:	Fulton

EAV was named “2016 distributor of the year”, and just as seen with Mark Phillips, the Company helps EAV Medical recruit new sales reps via Facebook by guiding them to email OrthoPediatics directly:



“Third Party” Distributor Trauma-Recon Reps Also Maintain Company Email Addresses

Tim Hinspeter is the founder of Trauma-Recon Corp, whose [website](#) claims that it “is the exclusive distribution partner of orthopediatrics in the northeast region.” The site lists 15 sales representatives, 13 of whom maintain OrthoPediatics email addresses and commonly hold themselves out as OrthoPediatics sales representatives. For example, see Luke Popko, whom Trauma-Recon lists as a rep:



Trauma-Recon Corp strikes us as highly problematic, as the maintenance of Company email addresses also mirrors Valeant Pharmaceuticals’ now-infamous relationship with Philidor Rx Services. See [SEC proceedings](#) against Valeant compared to what we now understand has occurred at OrthoPediatics:

Valeant / Philidor, per the SEC	OrthoPediatics / Distributors, per our Research
“Valeant provided an advance of \$2 million to Philidor”	OrthoPediatics provides capital to distributors through its “relief fund.”
“Valeant was involved in setting up its infrastructure and hiring of key employees ... Valeant advised and assisted Philidor on its launch and expansion...”	At least 6 former OrthoPediatics employees have become distributors; OrthoPediatics solicits resumes on behalf of its distributors.

"Valeant maintained a sales force to promote access to its products through Philidor to health care providers"	At least 13 Trauma-Recon sales representatives, and other "third party" distributors maintain OrthoPediatrics email addresses.
"Valeant agreed to reimburse Philidor for the cost of Valeant drugs that the third-party payors and insurance companies did not cover ..."	Per two OrthoPediatrics distributors, the Company allows for products purchased directly by distributors to be returned or resold.

We also find it worthwhile to note the similarities to the allegations made at MiMedx, whose CEO and COO were [just convicted](#) of accounting and securities fraud. Per the DOJ's complaint (in part):

"PETIT and TAYLOR repeatedly demonstrated and touted their understanding of these rules governing revenue recognition. They also publicly identified revenue as the principal metric reflecting MiMedx's growth, and **touted MiMedx's consistent record of quarter-over-quarter revenue growth** and meeting or exceeding revenue guidance in 17 consecutive quarters, from 2011 through year-end 2015. By 2015, however, it became increasingly difficult for MiMedx to reach its revenue guidance due to decreased demand from certain distributors and the increasingly aggressive revenue targets that MiMedx had publicly announced ... Confronted with the difficulties faced by MiMedx in meeting its quarterly and annual revenue guidance by legitimate means, PETIT and TAYLOR **engaged in a fraudulent scheme to falsely recognize revenue upon the shipment of MiMedx product to four stocking distributors...**"

Tellingly, two senior-level OrthoPediatrics executives are no strangers to such problematic situations.

High-Level OrthoPediatrics Executives Are Familiar with Channel Stuffing Schemes

Senior Managing Director Mike Pritchard is an Alumnus of ArthroCare

OrthoPediatrics also employs Mike Pritchard as a Senior Managing Director. In many of our conversations, both former executives and distributors attest that Mike Pritchard, Senior Vice President Greg Odle, and Dave Bailey are the muscle behind the OrthoPediatrics operation. From January 2008 to January 2009, Pritchard worked at ArthroCare as a Business Development Manager just prior to joining OrthoPediatrics:



Mike Pritchard OP
Senior Managing Director, Trauma & Deformity Correction--Central Region at OrthoPediatrics



Business Development Manager
Arthrocare Spine
Jan 2008 – Jan 2009 · 1 yr 1 mo

For those not familiar, ArthroCare orchestrated arguably one of the largest channel stuffing and securities fraud schemes of the modern era, with the [DOJ stating](#) "shareholder losses of over \$750 million". **The DOJ indictment reads eerily similar to the issues we've heard expressed by multiple former employees and distributors at OrthoPediatrics (emphasis ours):**

“The fraud scheme at ArthroCare began in 2005 and continued until 2009. Gluk admitted that he and his co-conspirators **determined the type and amount of product to be shipped to distributors based on ArthroCare’s need to meet Wall Street analyst forecasts, rather than distributors’ actual orders.** Gluk and others then caused ArthroCare to “park” millions of dollars’ worth of ArthroCare’s medical devices at its distributors at the end of each relevant quarter. ArthroCare reported these shipments as sales in its quarterly and annual filings at the time of the shipment, enabling the company to meet or exceed internal and external earnings forecasts.

ArthroCare’s distributors agreed to accept shipment of millions of dollars of products in exchange for special conditions, including substantial, upfront cash commissions, extended payment terms and the ability to return products, allowing ArthroCare to falsely inflate revenue by tens of millions of dollars, Gluk admitted.”

ArthroCare’s CEO was sentenced to 20 years in prison, two Senior Vice Presidents received 80 months and 60 months in prison, and its CFO 50 months in prison.

Mike Pritchard worked for ArthroCare during the fraudulent period before going directly to OrthoPediatrics, where multiple employees and distributors now attest to many of the same practices that landed ArthroCare executives in prison.

Mike Pritchard is not the only high-ranking OrthoPediatrics employee with a sordid history; CFO Fred Hite has also had a run-in with the SEC for similar fraud.

CFO Fred Hite’s Former Company Symmetry Medical was also Charged with Fraud

OrthoPediatrics CFO Fred Hite came to the Company having previously served as CFO of Symmetry Medical, Inc. Under Hite’s purview, Symmetry’s United Kingdom unit, TPC, committed extensive fraud. Per the SEC:

“The financial fraud at TPC involved the systematic understatement of expenses and overstatement of assets and revenues, and was achieved primarily by improperly and prematurely recognizing revenue, improperly capitalizing expenses, overvaluing inventory, and understating costs of goods sold. The scheme stopped only when, on September 24, 2007, a manager at TPC disclosed the scheme to Symmetry’s CEO.”

In fact, per the SEC, Hite appears to have turned somewhat of a blind eye to the fraud by failing to provide a report profiling the exceptions to Symmetry’s audit committee:

2. Moreover, in July 2006, Symmetry’s CFO (Respondent Hite), did not provide Symmetry’s Audit Committee with a copy of a status report concerning TPC by Symmetry’s former Director of Internal Audit (the “IA”). In the report, the IA identified exceptions at TPC, citing among other things bill-and-hold transactions, and failures by TPC (i) to provide requested evidence; (ii) to provide complete evidence; and (iii) to perform proper account reconciliations. In the report the IA also sought permission to solicit outsourcing proposals from other “Big Four” firms to provide, for the balance of 2006 and for 2007, internal audit services at TPC that would include “internal controls testing and financial audits” there. The IA resigned from Symmetry shortly after preparing this report, and accordingly, was not present at the next Audit Committee meeting (held on July 26, 2006) to present the foregoing findings and request concerning TPC. Hite—the conduit for materials to be included in board packets for directors’ consideration—provided the status report to the Company’s independent auditor, but did not include it in the Board Packet for the July 2006 Audit Committee meeting, and the Committee did not otherwise learn of the report until after the fraud at TPC was discovered in September 2007.

Per the SEC, the “accounting fraud was so pervasive that it distorted the financial statements of the parent company.” Thus in January 2012, the [SEC charged](#) four Symmetry executives and accountants and initiated [administrative proceedings](#) against Symmetry CEO and CFO Hite, who paid a \$25,000 penalty and forfeited \$185,000 in past bonuses.

We Find the Company’s Claim to “Steady” 20%+ Organic Growth Patently False

We believe that the Company’s “steady” and “consistent” 20%+ revenue growth has been artificially inflated not only by channel stuffing as detailed above, but, as the Company’s own disclosures illustrate, by M&A. **We estimate that excluding the June 2019 acquisition of Vilex/Orthex, the Company would have grown at just 11.7% in 2019, a significant step down from the Company’s highly-touted 20% level.**

In June 2019, [the Company acquired](#) Vilex in Tennessee, Inc. and Orthex, LLC (collectively “Vilex” and “Orthex”) for \$50 million in cash and \$10 million in stock. The cash required for this purchase was not provided directly from the Company’s balance sheet, but from related party Squadron Capital, LLC, which we detail further in this report. On the Q2 2019 conference call, CEO Throdahl was questioned as to the contribution of the acquired businesses to overall results, to which he replied:

“We’re not going to break out specifically what it is. The overall business, the growth is steady with or without Orthex.”

We think this characterization of “steady” growth is patently false and is a deflection from the Company’s poor standalone performance. This view is backed by the Company’s own disclosures of Vilex & Orthex financials made public in its 2017 and 2018 financial statements, as shown below:

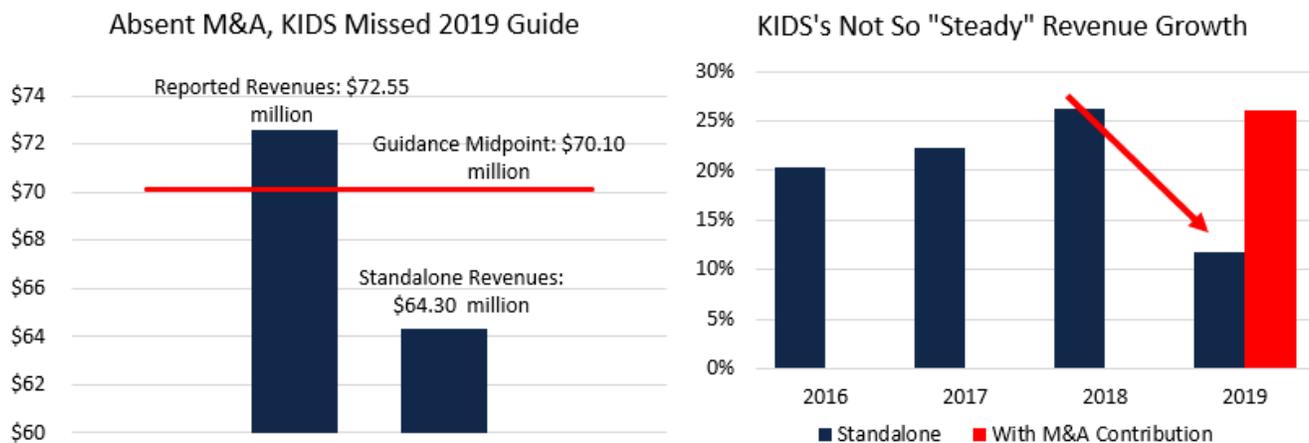
Vilex & Orthex Financials	2017 Act.	2018 Act.	2019 Est.	2020 Est.
Revenues	10.74	11.79	14.15	16.98
Cost of Sales	1.73	2.72	2.83	3.40
Gross Profits	9.01	9.07	11.32	13.58
Operating Expenses	5.54	6.01	7.07	8.49
Operating Income	3.47	3.06	4.24	5.09

While the Company chose to not disclose 2019 and 2020 contribution, we estimate that Vilex and Orthex grew 20%, backed by CEO Mark Throdahl's comments on the Q3 2019 and Q3 2020 calls:

Q3 2019: "We could not be more pleased with how well the Vilex/Orthex acquisition is going in the first full quarter we have owned it. We have seen significant interest by many of our surgeons in evaluating the Orthex system, and several of these evaluations have led to recent approvals at large institutions that Vilex had been trying to penetrate for the past 2 years."

Q3 2020: "Orthex continue to deliver strong growth with a number of new users and sales agencies performing their first cases."

The Vilex/Orthex acquisition closed on June 3, 2019, thus contributing nearly 7 months of business to the Company's consolidated 2019 results, or estimated revenues of \$8.25 million. OrthoPediatics guided to full-year 2019 revenues of \$70.1 million at the midpoint, and reported \$72.55 million. Thus, we estimate the Company would have fallen short of guidance by \$5.8 million had it not resorted to M&A, which pushed its full-year growth rate above the magical 20% level from just 11.7%:



This contribution is even more eyebrow-raising when considering that at year-end 2019, **after having fully recognized almost 7 months of revenue which allowed the Company to meet guidance, OrthoPediatics turned around and sold a portion of this business to a related party, Squadron Capital LLC, for \$25 million.** We find it highly coincidental that on the Company's March 2020 conference call, CEO Throdahl stated that this divesture was always the Company's intention, while Squadron Capital – a related party – was nevertheless the highest bidder. We believe that despite being a 30% shareholder, Squadron prioritizes cozy deals for itself rather than the best outcome for all shareholders.

Squadron Capital's Interests Are Not Always Aligned with Minority Shareholders

We believe Squadron has abused its position as the Company's former majority owner and single largest capital provider. Under the parties' most recent Fourth Amended Agreement, Squadron lent the Company a \$20 million term note and a \$15 million revolver. Each facility provides capital at a rate of LIBOR plus 8.61% or 10.00%, whichever is greater, and are secured by all of the Company's assets. In our view, these interest rates either reflect usury on the part of Squadron or a highly-distressed business in OrthoPediatics. Though Squadron Capital's first investment in OrthoPediatics wasn't officially made until 2014, OrthoPediatics has also been paying off a mortgage to Tawani Enterprises, Inc. which is owned by one of Squadron's board members. The mortgage began

in August 2013 and gathers interest at an annual rate of 5.0% until its August 2028 maturity. On a combined basis, since 2014, the Company has paid \$15.45 million in interest to Squadron & Tawani:

Interest Paid to Squadron & Tawani (\$ millions)	2014	2015	2016	2017	2018	2019	YTD 20
	2.55	1.23	1.48	2.49	2.26	4.23	1.22

Squadron Capital is also a supplier to OrthoPediatics through its ownership in Structure Medical and FMI-Hansa Medical Products. Since 2013, the Company has made a cumulative \$22.9 million in payments to Structure and FMI-Hansa:

	2013	2014	2015	2016	2017	2018	2019
Total Revenues	20.0 est	23.7	31.0	37.3	45.6	57.6	72.6
Total Cost of Goods Sold	6.0 est	7.1	9.4	10.9	11.2	14.9	17.9
Gross Margins	70.0%	70.1%	69.8%	70.7%	75.5%	74.2%	75.3%

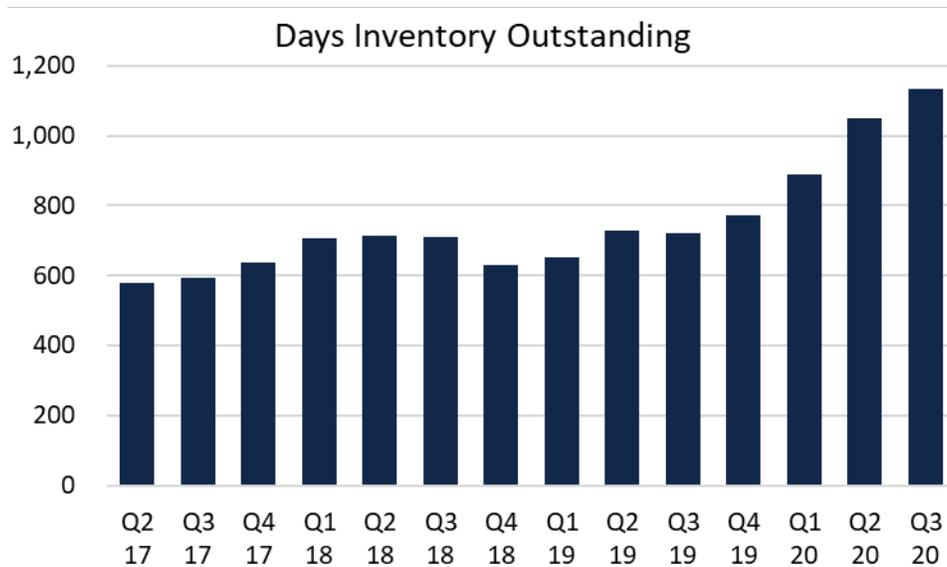
Payments to Structure & FMI	4.4	3.6	1.2	1.7	4.1	4.0	3.9
% of Cost of Goods Sold	73% est	50%	13%	16%	37%	27%	22%
% of Revenues	22% est	15%	4%	5%	9%	7%	5%

Structure Medical's production facilities are located in Florida, North Carolina, and Alabama – each hundreds of miles from the Company's Warsaw, Indiana headquarters. We think the Company could easily save on shipping costs by switching suppliers, but Squadron prioritizes its own interests above those of minority shareholders.

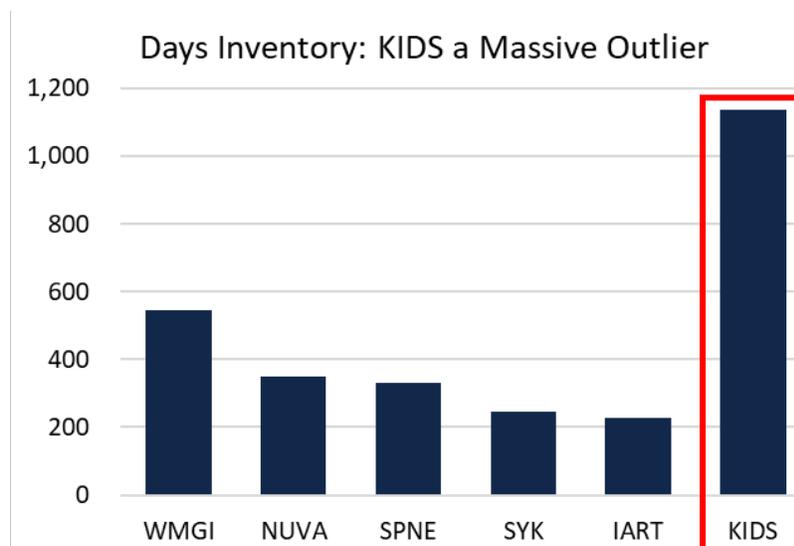
Moreover, as can be gleaned from the figures above, we believe that OrthoPediatics has unduly benefitted from non-arms-length contracts with these Squadron-affiliated suppliers. Two former OrthoPediatics executives told us that prior to IPO, Squadron's manufacturers supplied the Company at above-market rates, effectively looting OrthoPediatics to their own benefit. However, as Squadron prepared to publicly offer OrthoPediatics stock, it "flipped a switch" and supplied OrthoPediatics at below-market rates, **hence artificially inflating the Company's gross margins in preparation for the IPO**. Former executives described that from Squadron's perspective, this nominal loss was thought to be a small price for the resulting run-up that occurs in OrthoPediatics stock, which Squadron continued to own.

We Think OrthoPediatics Remains a Structurally Broken Business

Under the Company's consignment model, revenue growth is dependent on the inventory that has already been placed into the field. However, as OrthoPediatics has been consigning more and more inventory, it has converted that inventory to revenues at a slower pace; days inventory reached 1,135 days in the most recent quarter:



We find it highly difficult for OrthoPediatrics to explain away these bloated inventory levels as merely indicative of its consignment model, as other companies also consign products, yet hold far less inventory:



OrthoPediatrics claims to be a highly-innovative company which is constantly developing new products. In keeping with this line, the Company depreciates its sample inventory across a 2-year useful life, and its instruments across a 5-year useful life. **However, OrthoPediatrics now holds over 3 years of inventory on the balance sheet that it has yet to write down.** The Company wants to have its cake and eat it too, but its own financials don't stand up to the slightest modicum of scrutiny.

OrthoPediatrics has also employed a Loaner Program by which it ships entire sets of products directly to hospitals for surgeries on a one-off basis, after which the entire set is returned to the Company. Per our conversations with former employees and distributors, this program has grown in prominence as the Company looks to curb its bloated inventory position. In the words of Company Distributor #3:

“After [product is used] 3 times in 1 month, the shipping cost outweighs cost of sitting on the shelf. It can be \$600-700 per shipment going one way ... That [Loaner Program] keeps Fred’s [Hite, KIDS CFO] inventory turns where he needs it to be, and for cost of sales and all of that as well.”

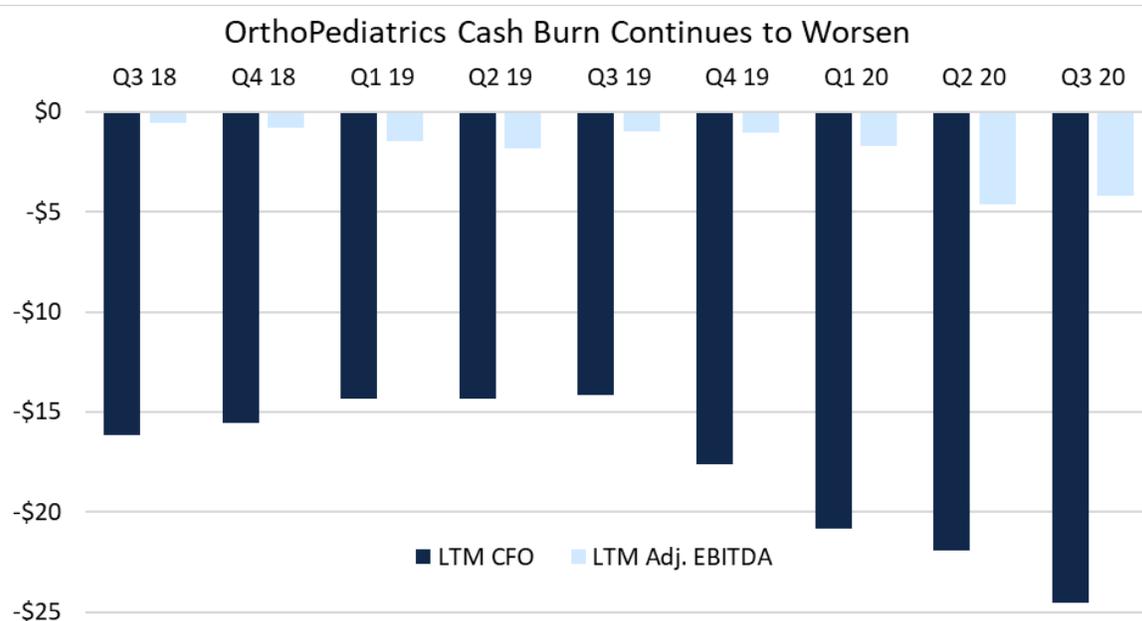
Moreover, we think the program has grown as the Company runs out of runway at its large accounts and is forced to move down market to smaller hospitals and surgery centers. However, these centers often cannot physically consign full product sets or have no desire to do so. That said, the proof is in the pudding; given the Company’s worsening cash burn, we see the program as another losing proposition.

In addition to this Loaner Program, OrthoPediatics also claimed that its acquisition of Orthex would improve capital efficiency. See multiple comments on the Q4 2019 conference call:

“... **we are deploying increasingly capital-efficient systems** while also beginning to realize revenue growth from the full rollout of recent product launches ... There is still tremendous demand for sets, but what we are trying to emphasize in this message is that **we are now beginning to back the deployment of more capital-efficient sets. The Orthex sets are much more capital-efficient than most of our legacy sets, ...**”

“... we are very concerned as a company about capital efficiency. And in fact, the investment decisions we make, any future acquisitions we make, much like the Orthex thing, will have to have capital efficiency box ticked. **And so, I think that will keep us from needing to be on a treadmill to oblivion** to increase capital deployment at the same pace as revenue growth indefinitely.”

We couldn’t have said it better: we think OrthoPediatics is on a treadmill to oblivion. While investors continue to pay upwards of 11x revenues for this elaborate scheme, the Company is tracking towards \$25 million of cash burn:



We are short OrthoPediatics, and given the myriad issues highlighted in this report, view shares as uninvestible.

Appendix 1: Company Distributor & Former Executive Interviews

The following are direct quotes from our interviews conducted with company distributors and former executives, edited for brevity and clarity.

Company Distributor #1:

One distributor described to us that OrthoPediatrics incentivizes distributors to purchase inventory directly from the Company by offering heavy discounts, returns, and increased future commissions:

“They’ll ask you to take it [inventory] off their books and they’ll renumerate you in different ways.”

“I can buy from them at their cost just to get it off their books ... If you bought something and didn’t use it then they’d look for an O.U.S. [international] distributor to take it ... It’s very common. This happens to 100% of people [distributors].”

“There were three or four times when I bought [inventory] ... I say [to OrthoPediatrics] can you give me any sort of increased commission potential and you go back and forth on what that commission bump would look like ... it can be 50% commissions for the next 6 or 12 months.”

Company Distributor #2:

One distributor described to us a situation in which he was instructed by the Company to purchase replacement product, even as product was not missing in the first place. Then, after the distributor ordered the supposed “replacement” product, it was never shipped to him by the Company:

“Anyway, it seemed like it was wish-washy when it came time to meeting end of the month quotas. We were good at it, but it got to the point where we met our quota every month, but if we didn't meet our quota for one month then the distributor bought inventory almost to meet his quota, and then would resell it at a negotiated price. Not to a hospital, but let's say a one-off surgery center type place.”

“A perfect example is my last paycheck was spent on femur plates and screws that were supposedly missing out of a femur tray. It's happened before where, if it's not in there and they get audited for inventory and it's not there, they make the distributors pay to restock those implants. Now, where is this implant actually going to is my question. Our job is to be in a surgery. When the surgery case is over, we write up a bill for what was used for that patient. Then that gets submitted to the hospital. The hospital then submits it, and then OrthoPediatrics ends up getting paid. With all of that said and done, and we're supposed to get the restock shipped out to us the next day, then even if it's on back order, why hasn't it ever showed up six months down the road? Something was really fishy between the way that the owner of my distributorship was doing things. It just didn't make sense. I ended up losing out thousands of dollars over something that I know for a fact wasn't on my part because, every time I do a surgery and I would order a restock, I would either get the restock within the next day or two, or I would have an explanation why.”

He also described “tons” of inventory that built up after the distributorship purchased “replacement” inventory from the Company:

"I've been over to my old boss's house before, and he would have tons of just back stock inventory, drill bits, screwdriver shafts. Sometimes my old boss would bill for screwdriver shafts on every surgery case, which shouldn't be because they're reusable. They're not single disposable screwdriver shafts at \$840 apiece. He was billing for them. They weren't being completely replaced. He ended up with a big stash of back order inventory, extra inventory. Where that stuff goes, who knows. He was billing the hospital for stuff that wasn't being used. If they're sending out restock inventory, where's that restock inventory going to if it's not being replaced?"

"At first, my boss, he actually has bought a couple sets, and he has so much back stock from stuff that extra inventory that he has over the years, and he'll make a set."

Company Distributor #3:

One distributor described to us how the Company offered him and other distributors equity-based awards, as well as how he purchases product directly from the Company:

"When I was 27, I joined and invested it was my life savings at the time to invest in OrthoPediatics ... I'm still a shareholder."

Question: "Does OrthoPediatics ever offer stock or RSUs to distributors?"

"They have awarded equity [to distributors] for performance. Distributor of the year in the past has gotten equity awards ... That's been the soapbox that I've stood on: If you want the distributors to increase [inventory] turns, they're more likely to jump off the couch on a weekend to get product out if they're invested in the company too ... I've seen the incentive of our team with the equity awards and the changes that have taken place since they've given awards."

Question: "Do you ever buy product from OrthoPediatics directly rather than consigning it?"

"Yeah actually I've probably got a quarter million dollars of inventory that I own."

Question: "Is that a common practice among OrthoPediatics distributors?"

"I'd say there's probably a few others that have done that as well."

Question: "How do OrthoPediatics commissions compare to peers?"

"Commissions have actually been a little higher, which is why a lot of people like us come there [to OrthoPediatics] ... They're paying more than some of the public competitors as far as the percentage goes. Sometimes maybe even triple ... J&J and Synthes will [offer commissions] up to the 15% to 18% range ... then [OrthoPediatics] can be 30% to 40%."

Company Distributor #4:

One distributor described to us how inventory sits unused in the channel, while OrthoPediatics consistently asks distributors to order supposed unnecessary product:

“You have tons and tons of inventory that’s being shipped into the field that’s just not being utilized ... I think that they overdid things a bit with the inventory. I don’t think that there needed to be that much more in the field, it just needed to be allocated better. I think they put in significantly more than they needed.”

Question: “Do they [OrthoPediatics] ever ask you to order product that you don’t need?”

“That happens all the time. There are times where I come to them but most of the time it’s the other way. They’re trying to get this stuff out to the field as soon as possible. And the other thing is, as they continue to update the portfolio, the distributors don’t want the old stuff, we want the new stuff.”

Question: “Are there any specific products that they ask you to order?”

“Yeah, it’s the implants. More on the deformity and trauma side, more deformity.”

Former Company Executive #1:

One former company executive described to us that Greg Odle, OrthoPediatics Executive Vice President, calls on distributors to order product, while claiming that “all of the distributors” have equity-based awards:

“Greg Odle made a call to distributors to ask them to buy product to make sales [projections]. So, what happened was the distributor cut a check to OrthoPediatics to buy full sets ... In my footprint, that happened to two people that I know of, and they weren’t even larger players ... We were quite a bit short [on revenues] going into [quarter end] ... I can only assume that everyone [all distributors] got that call.”

“There’s no way that product [sold to distributors] is ever going to turn ... its sits in cars, sits in garages...”

“Distributors get 250 shares each, then 50 or 100 shares for each rep. Absolutely [OrthoPediatics] pays distributors RSUs ... All of the distributors have shares, and continue to get shares.”

“A lot of this is unspoken about between distributors.”

Former Company Executive #2:

One other former Company executive described to us how distributors have purchased “entire sets” from OrthoPediatics, while the Company incentivizes these direct purchases with heavy discounts:

“I think distributors purchasing product now is more than it used to be ... There are times when they [OrthoPediatics] will sell entire sets to distributors. Among larger distributors, that’s becoming more frequent ... In the Northeast, in Los Angeles ... The fellow in Missouri...”

“When the distributors buy the sets, they buy the instruments too.”

“They [OrthoPediatics] can do that [encourage distributors to buy] by adjusting the price, making it more favorable for a bulk buy ... or [distributors] say ‘hey I want more sets consigned to my area’ too.”