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Transcript of
Bovie Medical Corporation
Third Quarter 2016 Earnings Call
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Participants
Rob Gershon – Chief Executive Officer
Jay Ewers – Chief Financial Officer
Jack McCarthy – Chief Commercialization Officer

Analysts
David Turkaly – JMP Securities
Charles Haff – Craig-Hallum
Swayampakula Ramakanth
Russell Cleveland – RENN Capital
Yitz Jacobovitz – AIGH Partners
Elliott Cohen – Oppenheimer
Rafe Quinn – Barc Partners

Presentation

Operator
Good afternoon and welcome to the Bovie Medical Corporation Third Quarter 2016 Earnings Conference Call. All participants will be in a listen-only mode. Hosting today's call will be Mr. Rob Gershon, Chief Executive Officer at Bovie Medical Corporation.

After today's presentation, there will be an opportunity to ask questions. Please note this event is being recorded.

Before we begin, I would like to make the following Safe Harbor statement. Today's call will relate to Bovie's third quarter 2016 earnings results and will contain forward-looking statements regarding predictions about future events. Forward-looking information is subject to certain risks, trends, and uncertainties that could cause actual results to differ material from those projected.

Although the Company believes that the expectations reflected in such forward-looking statements are based upon reasonable assumptions, they can give no assurance that its expectations will be achieved. The Company assumes no obligations to update or supplement any forward-looking statements, whether as a result of new information, future events, or otherwise.

With that, I would like to turn the call over to Rob Gershon. Please go ahead, sir.

Rob Gershon – Chief Executive Officer
Okay, thank you, Robby, and good afternoon, everyone, and thank you for joining us to review our third quarter financial and operating results and to discuss our business outlook. Joining me on today's call are Jay Ewers, our Chief Financial Officer and Jack McCarthy, our Chief Commercialization Officer. At the conclusion of our prepared remarks, all three of us will be available to answer questions.

We are very pleased with our third quarter performance as it illustrates the strength of Bovie's business model and strategic direction, and in many ways provides insight into where we can go from here. With the completion of our third consecutive quarter of solid double-digit sales growth, it is clear that we are scaling the business, building upon the foundation that we laid last year throughout our sales, R&D, and manufacturing organizations. Our sales growth is coming from each of our product categories, core, OEM, and growth, a strong indication of the underlying potential of our business and reflects our ability to drive growth in our mature core products category, manage demand from our OEM customers, and accelerate sales of our growth products like J-Plasma.

At the same time, we are tapping into the tremendous operating leverage that is a critical part of our business model by accelerating sales growth, improving the mix of higher margin products, and keeping operating costs under control. While continuing to invest in R&D, we succeeded in substantially improving our operating results in the third quarter. We cut our operating loss by over 86% to $245,000 and we're cash flow neutral one quarter ahead of schedule. Jay will provide the details on this in a moment. It is clearly a source of pride for the entire organization.

To drill down a little in terms of our revenue performance, our core product sales increased approximately 4%, reflecting year-on-year growth in electrodes, cauteries, lighting, and just about every product line including animal health, which our core products are very well suited for. In the first nine months of this year, we have grown our core product category by 9%, outpacing low single-digit market growth in this category, thanks to our ability to leverage the Bovie brand and our excellent distribution channel.

Our OEM business was up 2.5 times in the third quarter and grew at a similar rate in the first nine months of this year. This year's OEM growth rate was unusually high as we accommodated a large customer order. But based on our visibility, we expect similar results in 2017.

As I've mentioned in the past, demand for our OEM production is virtually all inbound and our expertise is so well regarded by some of the largest medical device manufacturers, that they have agreed to include powered by Bovie on many of their branded generators. Over time, we are targeting OEM to account for 8% to 12% of our annual sales as it uses shared resources and we want to make sure that we have the capacity to handle the increasing demand for our growth products.

Speaking of growth products, this was another strong quarter for J-Plasma sales, which reached $1.4 million. This was almost twice the levels of this year's second quarter, which represented a doubling from first quarter levels. J-Plasma sales in the first nine months have reached just over $2.5 million, more than 2.5 times greater than the same period last year.

In the third quarter, J-Plasma's performance represented double-digit sales growth generated by our Bovie sales force and the benefit of demo sales to our sales channel partners. We do not expect to see actual sell-through from our partners until late in the fourth quarter as some of our training sessions were completed in early September but others will not be done until early November.

I have personally participated in several of these training sessions to-date and I can say that they have gone very well, generating a lot of enthusiasm for the product. And our sales teams are working hard to support the efforts of our sales channel partners. Beyond revenue, another important indication of increased J-Plasma adoption is the significant growth in hand piece volumes, which in the third quarter increased a 166% year-on-year and 64% sequentially, and for the first nine months of this year were up 2.5 times compared to a similar period in 2015.

We recently learned that J-Plasma was named an Innovative Technology by Vizient, which is the largest GPO in the country. Following the review of Vizient's member councils and task forces, we were honored to learn that J-Plasma received this designationm which means that J-Plasma can be made available to Vizient's vast network of academic medical centers, community hospitals, integrated health delivery networks, and non-acute healthcare providers without having to participate in a competitive bid cycle. This is a great advantage that our sales force will certainly leverage.

We continue to work with our four current medical advisory board members to determine specific procedures within their respective specialties in which J-Plasma can become the standard of care. Dr. Patel's clinical study on J-Plasma's ability to reduce the incidence of lymphoceles is underway and we are planning other studies for next year to demonstrate and confirm the advantages of J-Plasma in specific clinical applications. Also, we expect to be able to announce at least one additional MAB member in the field of GYN oncology within the next few months.

Another highlight of the third quarter was our receipt of FDAs 510(k) clearance for our PlazXact Ablator, which fits into our growth product category and we believe has a significant potential from market share gains. Orthopedic ablators are mostly mature products but our innovative product, similar to J-Plasma, features a high level of procession combined with the additional safety of lower power setting and has the advantage of being compatible with most electro surgical generators. We are currently evaluating options for full commercialization of the product and have been exploring the possibility of one or more sales channel partnerships.

To sum up, this was an excellent period for Bovie Medical across the entire organization. I will now turn the call over to our CFO, Jay Ewers, to comment on our financial results. Jay?

Jay Ewers – Chief Financial Officer
Thank you, Rob, and thank you all for joining us today. It is clear that our third quarter results were very strong and we are quite pleased with what we have achieved through the first nine months of the year. The quarter and nine month results reflect our ability and commitment to drive revenue growth and leverage our cost structure while also investing in the business.

Following our strong performance in the second quarter, the positive momentum continued into the third quarter. Just to recap the highlights, we grew the topline 29%, achieved 900 basis points of gross margin improvement, substantially narrowed our operating loss, and were cash flow neutral in the quarter.

Now on to the P&L beginning with revenue. For the quarter total revenue increased 28.6% over the same period of the prior year to a record $10.1 million. J-Plasma, although still a small portion of overall sales, increased by 177% over last year and 83% over the second quarter of 2016. It accounted for 13.9% of total sales, up from 6.5% in the third quarter of 2015. In our other categories, OEM revenue increased 160% to $1.8 million and accounted for 17.5% of total sales for the quarter. Core sales increased 3.9% to $6.9 million and accounted for 68.6% of total sales for this quarter.

On a year-to-date basis, the results are similar, where we saw overall sales increased 27.8% over the same period in 2015. Core sales were up 9.1% to $20.3 million, OEM up 156.7% to $4.4 million, and J-Plasma up 163.2% to $2.5 million.

Moving on to cost and expenses. Along with strong revenue growth, we had significant gross margin improvement. We expanded gross margin to 50.3%, reflecting an improved product mix with an increasing proportion of sales coming from our higher margin OEM and J-Plasma products. As I noted last quarter, we expect to see gross margins trend in the mid-to-high 40s as OEM and J-Plasma sales continue to account for a larger percentage of our sales mix.

Turning to operating expenses, which again saw sequential and year-over-year improvement, we continue to manage costs enabling us to leverage our sales growth into a significant reduction in our operating loss. Total operating expenses were up 5.3% for the third quarter compared to last year, significantly below revenue growth. R&D spending increased 17% to $682,000 over the same period last year as we continue to invest in labs, prototyping, design work, development of new products, and the refinement of existing products.

We remain committed to leveraging our past R&D spending and going forward, expect it to continue to average from 6% to 8% of revenue. Salaries increased 13.6% to $2.2 million, reflecting new hires in quality, regulatory, accounting, and HR. SG&A expenses were essentially flat at $2.1 million and declined to 21.3% of sales from 26.9% of sales in the quarter of the prior year.

We continue to focus on leveraging every operating expense dollar, while still making important investments in our business. As a result, during the quarter, the operating loss narrowed to $245,000, down significantly from an operating loss of $1.8 million in the same period of the prior year. Although we expect the fourth quarter to be another strong revenue quarter, the impact on operating results will not be as pronounced, reflecting the timing of some R&D and other product development spending.

When you put this all together and include the $683,000 in non-cash expense attributable to the revaluation of derivative warrant liabilities, we reported a net loss of $964,000 compared with the $1.6 million loss in the third quarter of last year. On a fully-diluted basis, this translated into an EPS loss of $0.04 compared to the fully-diluted EPS loss of $0.06 we reported in the same period of the prior year.

Summing up with cash flow and the balance sheet. The balance sheet remains largely uneventful. We maintained our strong balance sheet and ended the quarter with $9.3 million in cash, virtually the same level we had at the end of this year's second quarter. Cash used by operations was $2.3 million for the nine months ended 2016 compared to $4.8 million through the same period in 2015, the result of a 44.7% increase in gross margin dollars, while operating expenses increased a relatively modest 7.9%.

We achieved breakeven cash flow in the quarter, one quarter earlier than expected. This was partially attributable to the timing of both cash receipts and expenses at a slightly different pace than we had anticipated. Our continued strong performance in this third quarter reflects the solid execution of our strategies and our disciplined approach to growing our business.

I will now turn the call back to Rob for some additional comments before we open the call for your questions. Rob?

Rob Gershon – Chief Executive Officer

Thanks, Jay. We are pleased with our positioning as we enter the final quarter of 2016 and move into 2017. First, we are firmly on track to exceed the 20% revenue target we had for the full year, which speaks to both the strength of our business and to the visibility we are gaining across our product categories. Second, we have demonstrated our ability to scale the business, while maintaining financial discipline. Third, we are partnering and preparing to partner with top surgeons and well-known and respect companies in our field to accelerate adoption of our growth products. And we have set the stage for continued strong growth in 2017.

Looking ahead to next year, we expect our core products and OEM product lines to show consistent performance, to see accelerated growth in J-Plasma sales from our multispecialty strategy and our sales channel partnerships, and for revenues to benefit from new additions to our growth product category.

On the expense side, we are in excellent position to drive profitability by leveraging our existing infrastructure and driving down operating expenses as a percentage of revenue. Finally, in early September, we began the development of a three-year strategic plan, which we expect to complete by the end of this year. Up until now, we have been operating with one-year plans but we are now in a position to look ahead and I can tell you the opportunities are substantial. We look forward to sharing more of our long-term vision with you as we move ahead in 2017.

Robby, at this point, I would like to open the call to questions.

Operator
[Operator instructions]. We'll pause a few moments to allow questions to enter the queue. We'll take our first question from Dave Turkaly with JMP Securities. Please go ahead.

Q: Thanks and congrats on the quarter. I'm trying to wrap my head around some of these numbers but maybe I could just start with the sales force and your direct effort. I know you mentioned you had some demo sales to channel partners, but I'm imagining the majority of the sales came from your direct folks. So any update on the size of that force and then I guess maybe some color on how they're recognizing so much success this quarter, say, versus the last several?

Rob Gershon – Chief Executive Officer
Sure. Hey, Dave, thanks for your question and thanks for your kind congratulations. You are exactly right, the majority of the sales did come from the direct sales force as one might expect. I'll tee it up and see if Jack wants to add any additional color, but in terms of what is fueling the success, first of all the sales force remains exactly the same size, we have not added any incremental heads to the sales organization so it remains the exact same size as it's been all year along.

And why is the success ramping up? It's very much tied to the same things we've been talking about for quite some time, which is while we know it's a long sales cycle, we've had a robust pipeline of activity that we simply work through. And what has been happening is things are coming to fruition just as we expected it to in the timeline, which has changed overtime of course, but in the time horizon that's been fairly predictable this year. So in general, that would be my response, I don't know, Jack, if you have any additional color you'd like to add?

Jack McCarthy – Chief Commercialization Officer
I would just add that it's an execution story and we came out in the plan in the beginning of the year with a pivot towards moving into surgical oncology, GYN oncology, and more focus on plastics and that has paid dividends.

Q: And then, obviously, we talked a little bit about the plastics, Jack, and the 510(k) approval. I guess, as you look at new technology, and I believe you're working on several others. How do you look at the partner versus maybe having some of that go through direct areas as well, well some of the newer products that you're coming with, be [ph] it in the hands of your direct folks or are most of those going to be partner opportunities?

Rob Gershon – Chief Executive Officer
Yes, it's a great question and you're exactly right. One of the themes that we've been talking about for quite some time is unlocking the value of Bovie through our R&D efforts. So mostly through organic growth and we certainly have a robust pipeline of products that we plan to launch. And we keep an open mind in terms of the most efficient sales channel to work, to deploy, to launch these products through. Right now the early thinking is for those products mostly that go through our direct sales force and then to ramp up the direct sales force as we add different products to the bag. That is subject to an evolution of thinking as we learn more, as we continue to go down this path.

Q: And last one from me, I mean gross margin obviously up a lot in the quarter, mid-to-high 40s is a target, I guess. But given that you're at 50 and J-Plasma and OEM are expecting to continue to be strong, I guess why wouldn't it be even—I mean it's not a big improvement but could it potentially be higher? And may be just remind us, if you can, what the level of where those two areas are versus say your core is today.

Rob Gershon – Chief Executive Officer
Yes so I'll go ahead and start and invite Jay to add additional color. You are exactly right, the target that we've actually had as well is in the mid-40s as we start seeing this shift, this product mix shift of the business, with OEM and especially J-Plasma playing a much, much larger role. So that, clearly, as you see the shift in the business, you heard it a little bit in Jay's prepared remarks, you see the shift moving while the overall business is growing, without question and each of the three categories continue to grow. It's the growth of the higher margin products in OEM and especially in J-Plasma that has resulted in that gross margin improvement and it occurring in the 50s now. So it is subject to product mix on a quarterly basis and certainly our intention is to continue the trend that we're on right now where J-Plasma will take on—or the whole growth category will take on a higher percentage of the overall product mix.

Jay Ewers – Chief Financial Officer
And to your second question, is there upside to that margin potential. Certainly, as the mix continues to grow and skew more towards the OEM and J-Plasma, we would expect that margin to increase as well.

Rob Gershon – Chief Executive Officer
Right as the mix—yes, and what will drive it, it's certainly the mix and over time, as you might expect for any product that's in the early stages of commercialization, over time there will be inherent cost efficiencies to be had that will also go right to margin improvement just from a manufacturing and production perspective.

Operator
We will take our next question from Charles Haff with Craig-Hallum. Please go ahead

Q: Hi, guys. Congratulations on a great quarter. I had a bunch of questions here, I could just rattle them off if that's okay. So accounting for demo sales to channel partners, how is the accounting handled, Jay, for demo sales?

Jay Ewers – Chief Financial Officer
They are included in the revenue line for J-Plasma.

Q: And then the expenses for the channel partners, where do those go?

Jay Ewers – Chief Financial Officer
So there really aren't a lot of expenses for the channel partners.

Rob Gershon – Chief Executive Officer
Right and what we haven't publicly disclosed is the economic relationship between our sales channel partners and Bovie.

Q: So is it setup now is more of a classic distribution model where you sell it at a discount and then they'll mark it up to your ASP for their customers?

Rob Gershon – Chief Executive Officer
Yes, not at this time, it is not set up that way.

Q: Okay. When do you think you may be disclosing that? I know I get that question from a lot of investors?

Rob Gershon – Chief Executive Officer

Well, as you know, the sales channel partnership with Hologic, right now, is in a pilot phase. So we wouldn't be in a position, if we were to disclose the economic relationship, until that's a permanent agreement. So the pilot portion of our partnership will go until the end of February. So you could look at some period after that before we can announce a permanent relationship and we'll decide at that point in time if we're going to elaborate on the economics of the relationship.

With respect to Arteriocyte, as we explore sales channel partnerships on a go-forward basis, just for purposes of confidentiality and the ability to secure additional partnerships, it's just for—our strategy is just to be quiet on the economic relationships until they become a little bit more mature and routine, that's the approach that we're going to take right now.

But what we have commented on is they're very efficient economic relationships, in other words they have been accretive. I think I mentioned that in our last earnings call that this cost structure is rather efficient and it is more efficient than even our direct sales force.

Q:: Did that efficiency help you in gross margin for this quarter as well?

Rob Gershon – Chief Executive Officer
Not yet because it's too early. Nearly all of our sales have come from the direct sales force and it's too early in these two programs for counting revenue generated by the sales channel partners because of what I mentioned in our prepared remarks in terms of the timing of training and onboarding. So we expect those partnerships to really start contributing in late Q4.

Q: Okay, but just to be clear you did have some revenues from the sales channel partners this quarter, right?

Rob Gershon – Chief Executive Officer
Not in Q3.

Q: Oh, okay. None?

Rob Gershon – Chief Executive Officer
Not in Q3.

Q: And then when you say, expect to be material in Q4, what's material by your definition will that be like--?

Rob Gershon – Chief Executive Officer
I didn't say material, I think that's when the sales will start and to be very candid, it's hard to predict. So that's why we really can't provide guidance. Certainly it's started and we think that the real uptick in sales will occur in late Q4 but some sales have already started. So it's just hard to say. Once we have a good feel for it, we'll certainly be transparent as we can.

Q: Okay, well that's kind of different from the rest of medical device companies. It's usually hard to get sales around the holidays, late in Q4, so that would be definitely unique among your competitors.

Rob Gershon – Chief Executive Officer
They do [ph].

Q: Then you mentioned on J-Plasma to expect accelerated growth of J-Plasma sales. We've already seen some really impressive growth so far this year relative to last year, so what you're saying is the growth rate that you expect to have for full year '16 should be exceeded in 2017, right?

Rob Gershon – Chief Executive Officer
Well certainly, we do expect that in 2017 the sales of J-Plasma will exceed that of 2016 and we'll comment more during our Q1 earnings call on 2017. We'll provide some level of guidance then when we have a little bit more visibility.

Q: Okay, so you're not saying the growth rate would be accelerating in '17, you are not going that far yet. Stay tuned there?

Rob Gershon – Chief Executive Officer
Exactly, stay tuned. Once we close out the year and we report on Q4 earnings in early next year, then we will comment on some specific guidance for the year.

Q: Okay, got it. And then how about on Dr. Patel? I know he's working on a very important urology publication with 100 patients. I think you said on the last conference call that maybe publication or presentation in the first half of '17. Has Dr. Patel given you any updates on that or any new news there in terms of timing or any changes to your thinking there relative to the last call?

Rob Gershon – Chief Executive Officer
Yes, no changes on the timing. So certainly we've been in contact and the timeframe has not changed.

Q: Okay, and how's his enrollment? Did he share any—I mean does he have most of the patients enrolled now or?

Rob Gershon – Chief Executive Officer
Yes he hasn't cleared us to comment specifically on the number of patients enrolled but the timeline remains unchanged and given his high volumes, as you would expect, he's getting through the study at a rather fast clip.

Q: Okay, great, and thanks for indulging me here a couple more. Jay, for international revenues in the third quarter, do you have that number handy or maybe it was in the press release and I just missed it?

Jay Ewers – Chief Financial Officer
No, I sure do, Charles, thank you. Domestic sales were about 87% and 13.2% for international.

Q: Okay, great. And any foreign currency impacts in the quarter anything?

Jay Ewers – Chief Financial Officer
No, no.

Q: Okay. And then just quickly on OEM, you mentioned last quarter that you had two large OEM contracts that were signed and you expected them to accelerate your growth rate and your visibility. Your accelerated growth rate would last for a few quarters, clearly you have shown that this quarter. Any new contracts that have been signed or any change to your view there? I see that you're guiding 2017 to similar growth rate of '16 so maybe there is no change, but I just want to clear that up if there was any changes and maybe changes to the upside in terms of new large OEM contracts?

Rob Gershon – Chief Executive Officer
Yes, so no changes, no changes. This part of the business becomes fairly predictable because the contracts tend to be long in duration. So we have some visibility going out. But there certainly is upside and there is

nothing to announce at this point in time but we expect to see 2017 be at a similar level of revenue as 2016, with upside to it.

Q: Okay, and it sounds like OEM is turning into a lot higher margin business than it was, say, a year or two ago. What features and benefits are you adding to your boxes now that maybe weren't in place a year or two ago that is adding to the margin profile of OEM for you guys?

Rob Gershon – Chief Executive Officer
Yes, so we can't comment on the specific features and benefits because that is, as you might know, the OEM projects are confidential in nature, so we don't comment specifically on that. But we've done a few things to really drive the margins up in the OEM business, primarily getting paid fair value for the contributions that we're making, so it's been more of a pricing strategy than anything else.

Operator
We will take our next question from Swayampakula Ramakanth. Please go ahead.

Q: Thank you for taking my questions, just couple of them. Obviously your gross margin seems to be doing pretty good. I'm just trying to understanding once you have J-Plasma and PlazXact contribute better than what it is doing now here, where do you eventually would like the gross margin to be, say, in two or three years down the line from here?

Rob Gershon – Chief Executive Officer
Yes, I will start and again invite Jay to add any color commentary. Certainly we want it to be higher and we expect it to be higher as the product mix changes. It's quite intuitive that that's what will take place. We haven't provided very specific forward-thinking guidance on, ultimately, what the impact will be, certainly in a two to three-year time horizon. But we have commented in general on our margin profile with the core business being in the 40s, the OEM business being in the 50s, and the growth business being in the 60 plus. And as we see a pronounced shift to more OEM and especially more in the growth, we certainly expect to see that margin climb.

Q: Okay, thank you. And from what I hear, it looks like the OEM contracts could be kind of lumpy because it looks like the second quarter revenue jump-off of about 19% compared to the first quarter seems like it was based on that. And in the third quarter you saw about a 9% growth compared to the second quarter. So it looks like, as I said, it looks like the OEM seems to be a bit lumpy. So how do you plan to normalize this so that you can assure yourself of a steady growth across the quarters?

Rob Gershon – Chief Executive Officer
Yes it's an excellent, excellent question and you are exactly right. The OEM business is inherently lumpy and that is why I mentioned it in the prepared comments that our intention is to keep the OEM business between 8% and 12% of our overall revenue, largely because not only do we use shared resources across all product categories, but to offset the inherent lumpiness in this business. So that if we see it from quarter-to-quarter, it doesn't have a dramatic effect on the overall.

Another way, because this is not a new issue being lumpy, in fact, the lumpiness was much more pronounced in years past and a change that we made, just about three years ago, is we started—these contracts typically on average are five years in length—and what would happen is we would complete one contract and, not lose business, but the businesses go away because the business is completed. So to guard against that, we started entering into new contracts that had staggered expiration dates, so that we could smooth out as much as practical, the lumpiness of the business. And as of late, while the business has been lumpy, it's been lumpy in a good way since it's been growing and what we're trying to do is make certain that it is as steady as it can be.

Q: And then the last question from me is on the new recent launch of PlazXact. You know, obviously, you're talking something about trying to get to full commercialization through and our sales channel partnerships. I'm not sure if you answered part of this question earlier but I'm just trying to understand where you are with that strategy. How do you plan to execute this in the next couple of years so that that way you would help your growth products to get a better percentage and beat down that OEM percentage?

Rob Gershon – Chief Executive Officer
Yes, so with PlazXact, we were very clear in our last call that as we commercialize this, we do want to enter into these sales channel partnerships and we reiterated that during this call. That will be critical for us in launching. So in other words, we do not envision PlazXact being sold through our direct sales force. This is going to be a sales channel partnership and this sales channel partnership will look much more like a distributor, a stocking distributor, but very focused. So that's what we're envisioning, though it can go in a few different directions because nothing is set in stone.

Ever since we announced that we want to enter into a sales channel partnership for this orthopedic ablator, there's been quite a bit of inbound interest in exploring that. So we have a process in place to vet these out and we're going down that path and we really see this to be a first part of 2017, first half of 2017, play.

Operator
We will take our next question from Russell Cleveland. Please go ahead.

Q: First of all, congratulations, excellent quarter just all across the board. So got two questions. One of them is about plastics dermatology, which seems to be an area that can be very, very large for J-Plasma. I know that we were going to do our own test so that we could advertise ourselves about this. And so I wanted to get some timing on that and where we are in this whole dermatology area? And then I have an accounting question for Jay, but first of all give me your thoughts on the whole plastic dermatology area?

Rob Gershon – Chief Executive Officer
There is no question that plastic surgery is a big opportunity for J-Plasma and that our growth, in part, is certainly due to plastic surgery, it has the shorter sales cycle and we are certainly experiencing the success of that strategy as Jack alluded to earlier.

But as you know, using J-Plasma for plastic surgery has a lot of indications that we already have through our broad-based indication of soft tissue, J-Plasma and soft tissue. So that covers a lot of procedures that the plastic surgery community performs, but one that is off-label, so that means we can't advertise it, so I know, Russell, that's exactly what you're referring to, does require a specific 510(k) indication, so this is for skin resurfacing. So we are beginning this effort in this quarter, in Q4, and it will take some time because these patients will not only have to be enrolled but they have to be followed over a period of time, and we'll come to an agreement with the FDA what that period of time is, but it could consume a good portion of 2017.

So what that all means is while we can't promote it for use, it is being used every day, to our understanding, for this procedure but we will not be able to promote it until we receive the specific 510 indication. So you can think at probably at the very earliest, it would be in the back half of 2017 and could be even longer than that.

Q: Right. But the individual MDs can do whatever they want in their advertising and show before and after shots and so forth?

Rob Gershon – Chief Executive Officer

Yes, they can and they do and it's gone quite viral. So if you start Googling you'll see things, but it is in off-label use and what it's not is contra-indicated. So off-label, the MD can do whatever he or she wants to do, but if it's contra-indicated then that's off limits and that's not the case for us. For us, it's an off-label use.

Q: Well I always joke about this, there's a lot of wrinkles in America today that could use this. Anyway the question for Jay is this, it's obscuring our results a little bit, this derivative warrant thing that I thought we got rid of, the re-evaluation of derivative warrants. Could you talk about that and that would be something that would be good to get rid of at some point because it obscures the actual bottom line here by couple [indiscernible] by 683,000 and could you comment on that, Jay, please?

Jay Ewers – Chief Financial Officer
Sure, I'd be happy to, Russell. So we have about 250,000 placement agent warrants outstanding related to the 2013 capital—injection of capital by Great Point Partners, they're not held by Great Point Partners, these are placement agent warrants, there's about 250,000 plus or minus still left outstanding and they're levered to our stock prices.

So as our stock prices—it's kind of counterintuitive—as our stock price rises, we have to book a loss on the mark-to-market accounting value of those warrants. So our stock price went from $1.54, I believe, at the end of the second quarter--$1.64, sorry, and it closed on September 30 of $5.21. So we booked that loss. Those placement agent warrants are declining and they are going away. We had an exercise in Q3 of some of the warrants, and I think as that problem's going to—not problem, but that obfuscating of our results will be going away shortly.

Q: You think long-term they'll be gone in X quarters probably?

Jay Ewers – Chief Financial Officer
Yes, yes.

Operator
We'll take our next question from Yitz Jacobovitz with AIGH Partners.

Q: First of all congrats on an amazing quarter, finally getting J-Plasma to do what we thought it could do for a while?

Rob Gershon – Chief Executive Officer
Thanks, Yitz.

Q: But I guess, just to confirm what I thought you said earlier, none of this quarter's contribution has come from either of the two strategic partnerships, not from Hologic or from Arteriocyte?

Rob Gershon – Chief Executive Officer
Yes, so not from direct sales to end-user customers. So in the number, our demo product that we armed both Hologic and Arteriocyte sales forces with, that is in the number. The majority of our sales, of course, came from our direct sales force to end-user customers. So of the end user customer sales, none of that came from either Arteriocyte or Hologic.

Q: I guess what I really would love to understand is should we see—I mean the sequential growth has been unbelievable, especially this quarter the last quarter. Should we expect continued sequential growth in J-Plasma?

Rob Gershon – Chief Executive Officer

Yes, so the sequential growth that occurred from Q2 to Q3 was largely driven by the sales reps and certainly we do expect the sales rep growth to absolutely be sequential from quarter-to-quarter into Q4.

Q: Okay, sounds good. Do you feel comfortable at this point, that enough of this revenue is recurring that you can put some numbers now or maybe next quarter around '17 for J-Plasma? Meaning is J-Plasma on a steady, staid trend upward or a trend line that you can draw at this point where you have enough recurring revenue to have confidence around some projections?

Rob Gershon – Chief Executive Officer
Yes it's an excellent question and the answer is this, it's becoming a little bit more clear what our direct sales force can do and the recurring revenue that they're able to generate. So I would say it's too early now to comment on 2017, but by the time we report Q4, in early 2017, we'll probably have a pretty clear view on what the direct sales force can do. What we won't have the benefit of because it's just simply too early is how big will the contributions be from our sales channel partners. We're just in the earliest of innings on that and that one is just a little less predictable but we might have a pretty good view by the end of this year and by the time of our Q4 earnings call. So if we do we'll share it.

Q: Okay, great. And just remind me again, I'm sure you went over this a lot of times, but just besides Arteriocyte's sales force that that has Bovie, I don't know, in the bag or however you want to look at it, versus what you have in-house?

Rob Gershon – Chief Executive Officer
Yes we haven't commented and we're not cleared by either of our sales channel partners to comment on the specific size of their sales organizations for their competitive reasons. So the only comment that we've made is it is certainly a multiple of ours, so considerably larger than our sales organization.

Operator
We will take our next question from Elliott Cohen with Oppenheimer.

Q: Hello I'm very pleased to see the revenue get into double digits finally, it's been a long time. I'm wondering—I have several questions. I'm wondering since you use the same factory, I believe, for the J-Plasma, your proprietary products, and OEM, are there any capacity constraints?

Rob Gershon – Chief Executive Officer
Good question, Elliot. So we have three manufacturing facilities. We have Clearwater. We also have one in Bulgaria in Sofia, Bulgaria. Those are owned manufacturing facilities. And then we have a contracted manufacturing facility in Ningbo, China.

In all three facilities, with respect to J-Plasma, all three actually touched J-Plasma, or proprietary products, although in Ningbo it's just the injection molding, and all three have additional capacity to meet the accelerated growth that we're experiencing both in J-Plasma and in the OEM product category that you just mentioned. So no real significant investments needed beyond adding additional shifts. So we're in a very good place to expand our capacity considerably by simply adding shifts.

Q: Okay, good. On the J-Plasma, I wonder how many units were sold and what that contribution is versus the consumables on the J-Plasma.

Rob Gershon – Chief Executive Officer
Right. So we don't report on the number of generators that are sold versus the number of hand pieces. The only metric that we do report is the growth of our hand pieces. As I mentioned in our prepared remarks, that grew

166%. Having said that, as you might expect from the uptick in revenue, we are certainly seeing an uptick on the capital side contributing but it still remains the majority of our sales comes from the recurring revenue.

Q: Okay, approximately how many units are in operation currently?

Rob Gershon – Chief Executive Officer
Yes, again it's not a metric that we do report on. We shifted when we—a couple of calls ago, we started the story, we reiterated on the last call, is as we commercialize this product, we view this as a two-step process, building a foundation for substantial and sustainable growth being the first part of the process and then scaling the business being the second part. And as we shifted, after Q1 of this year, into scaling the business, we really changed our narrative a little bit and stopped reporting on all of these detailed operating metrics and rather reported on the overall metrics of Bovie Medical being a 20% grower and also to illustrate the growth and adoption of J-Plasma to report on the growth of our hand piece sales, the recurring revenue. So that's what we're really sticking to.

Q: Okay, well let me press the issue a little bit. The intuitive on surgical, I believe the J-Plasma has been adopted to that. How is that procedure or how are those procedures going and is there any kind of indication of adoption more widespread because almost any hospital that wants to do plastic surgery has this da Vinci robot?

Rob Gershon – Chief Executive Officer
Yes, it's an excellent question. So when we launched back in, I believe its March of 2016, we launched the latest configuration of J-Plasma called the Precise 360. And it is this configuration that surgeons are using down the accessory port of the da Vinci robot. So for example, in Dr. Patel's study, I think he outlines this in his protocol, that this is the instrument that he is using, so all of his entire study is within the robotic platform.

So it is that version that is now being used with the da Vinci robot. We have also alluded to the development of future configurations, that were not overly specific, for the product to be designed to be even more usable down the accessory port and potentially even integrated into various robotic systems. So we haven't commented on the specific robotic systems. What we have commented on is that we are working with many of the existing and emerging robotic companies in that regard.

Q: Okay, now my very poor research suggests that by 2019 or so, the electrosurgical market is going to be about $4 billion here. What do you think is the biggest holdup to getting your products more significantly out in the marketplace?

Rob Gershon – Chief Executive Officer
When you say your products, are you referring to J-Plasma or are you thinking more broadly of the electrosurgical generators and the accessories that—which are mostly commoditized accessories that connect to—.

Q: The latter.

Rob Gershon – Chief Executive Officer
The latter. Yes so it's interesting because a portion of our business and a portion of our growing business comes from OEM and the OEM projects are all around electrosurgery, so both—mostly on the generator side but also on the accessory and the power supply side. And so we participate in that part of the growth through OEM. We also, in our core legacy business, we are also the manufacturer of some of the generators that are just marketed under either distributor names or some of the large manufacturers' names. So we are participating in the industry in that way and it's growing for us.

And we expect it to continue to grow, especially on the OEM side. We keep mentioning that we want OEM to represent 8% to 12% of our overall revenue. And we mean that and it could be higher but we expect our overall revenue to grow and we expect the OEM business to grow with it. This business is virtually all inbound, as I mentioned in our prepared remarks, and we absolutely turn away an awful lot of business. So it's a lever for us and it's something that we contemplate as a management team quite frequently, how much bigger we want to play in that electrosurgical space.

Operator
And we will take our next question from Rafe Quinn with Barc Partners. Please go ahead.

Q: Hi, thanks for taking my question. Just wanted to get clarification on few questions that have been asked previously. I guess first you had mentioned that a portion of the sales in the third quarter came from the channel partners, the demos sold to them. I was wondering if any of those type of demo sales occurred in the second quarter. I don't think they did based on the timing of those announcements but just wanted you to confirm that?

Rob Gershon – Chief Executive Officer
Yes sure, a very, very modest amount occurred in the second quarter, completely immaterial. So some of it, all of it, almost all of it occurred in the third quarter. But again the majority of the sales were not the demo.

Q: Got it, and so may be just to help us understand on an apples-to-apples comparison of sequential growth, could you tell us what portion of it did come from the demo sales to channel partners?

Rob Gershon – Chief Executive Officer
Yes, without breaking it out in numbers, what we are willing to comment on is double-digit sequential growth absolutely from our direct sales force.

Q: Okay, I mean were you up or down sequentially excluding the channel partners, the demos to channel partners?

Rob Gershon – Chief Executive Officer
Up sequentially, double-digit.

Q: Sequentially, not year-over-year. Got it, okay.

Rob Gershon – Chief Executive Officer
Correct, up sequentially, double-digits, yes.

Q: Okay, great, great. And then --

Rob Gershon – Chief Executive Officer
And then triple digit yes year-over-year, go ahead.

Q: And then over to the skin resurfacing side that you mentioned you're talking about little earlier with somebody else, I wanted to touch on that. I guess two pieces there, number one I'm curious is that a meaningful portion of the sales in J-Plasma thus far? I mean would you say it's greater than half or how should we think about that in terms of the contribution that you've had?

Rob Gershon – Chief Executive Officer
Yes, the way to think about that is that most of the sales come from the GYN, just overall. Having said that though, the shorter sales—I'm just going to just take a step back for a moment. The sales, this is your classic razor blade, razor model. So you have the generator is the capital piece of equipment, that's your razor and then the recurring revenue comes from the hand pieces.

The sales cycle for the capital piece of equipment is much, much longer for the GYN surgeon, especially because that's in the acute care environment, the hospital environment and you have to navigate that long sales cycle. On the plastic surgery side, which is where this skin resurfacing is happening, the capital piece of the sale is considerably shorter, sometimes measured in days and in a couple of cases measured in hours, so it's really a short, short sales cycle relative to the acute care.

So with that a lot of the generator sales come from the plastic side. But a disproportionately high amount of the hand piece sales comes from the GYN side, which is exactly what we would expect and it illustrates the adoption.

Jack McCarthy – Chief Commercialization Officer
I do want to focus too on the plastic sales. The focus on the sales force is on wound debridement, breast reconstruction, indicated procedures in plastics. So I know that this isn't talk of general resurfacing but that's not the focus for our sales organization.

Q: Got it, so it sounds like, just to confirm, you guys have not marketed skin resurfacing yet?

Rob Gershon – Chief Executive Officer
Absolutely not, no because we don't have the specific 510 clearance to do so. So we are very, very conservative by nature and we follow that FDA guidance to a T.

Operator
So we will take our final question from Charles Haff with Craig-Hallum.

Q: Hey guys, thanks for taking my follow-up question. In terms of the J-Plasma boxes that were sold this quarter, how would you split that between the ultimate boxes and the standalone J-Plasma boxes, are they all ultimate boxes at this point or you still selling the standalone J-Plasma box?

Rob Gershon – Chief Executive Officer
Yes, so I'll comment, I'll start and certainly invite Jay and Jack to add more color if you have it because I don't have the specifics. But our focus and really our customers focus has been much, much more on the Ultimate. So the ultimate, as you know, Charles, combines Monopolar and Bipolar, that is used and found in every on the planet, with J-Plasma. And that utility has been much, much more attractive despite the price point being considerably higher. It has been a much more attractive product for our customers. So I know the vast majority are the Ultimates and I don't have the breakdown at the top of my mind.

Jack McCarthy – Chief Commercialization Officer
I don't have a breakdown either but again the focus is definitely the Ultimate, we really focus on the Ultimate model.

Q: Okay, Jack, and question for you, Jack, on that. Obviously these hospitals that we speak to and offices, they already have an RF Box in most cases, it's paid for, it's basically free sitting there. So it's very interesting that they are willing to pay the higher ASP for the Ultimate box considering they already have that other one there. Is that kind of a function of saving real estate in the operating room or I mean what do you think the reason is that they're willing to just get rid of their RF Box and do this upgrade to your Ultimate machine?

Jack McCarthy – Chief Commercialization Officer
Yes, I think the keyword is upgrade, it is an upgrade, you have a new technology and most of the practices have had those boxes for quite some time and there's a shelf life on them. So this is an opportunity for the surgeons to upgrade their equipment and get something that they probably need to replace anyway.

Rob Gershon – Chief Executive Officer
Yes, the average shelf life on these generators, on these standalone Monopolar and Bipolar is about seven years. So what most hospitals do is they budget to replace that fleet, a portion of that fleet of generators every year. So that's where we're seeing some level of interest is when that occurs—and you're right, Charles, spaces is definitely at a premium, so having a three-in-one is very, very attractive and the ability to not add an additional box.

Jack McCarthy – Chief Commercialization Officer
And then when you look at it, we also have a four-year warranty on our equipment and the industry standard is one-year warranty. So they probably have service contracts bundled into there as well, so it may not be cheaper, but when you consider that we've got four-year warranty on our equipment.

Jay Ewers – Chief Financial Officer
And Charles to your question as to what the boxes, 90% in the quarter were Ultimate, the other 10% will be GS 100s.

Operator
And we have no further time for questions. So I will now turn the program back over to our presenters for any additional or closing remarks.

Rob Gershon – Chief Executive Officer
All right, thank you, Robby, and thank you everyone for participating in today's call and we look forward to keeping you informed on our continued process.