

Financial and Risk Analysis of Kontour Medical

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Abstract. Orthopedic medical devices are one of the largest sub industries in the medical device industry, and orthopedic implants are the most important category of orthopedic devices, usually devices and materials that are partially or completely implanted in the human body after surgery or surgery to replace, support, locate, or repair tissues such as bones, joints, and cartilage. This article introduces situation of medical device industry and Kontour Medical Co., LTD (Kontour Medical). By analyzing the key financial data of Kontour Medical and comparing the data with other similar medical device companies, including the income statement, balance sheet. In addition, the profitability, liquidity, solvency and operating performance of the Kontour Medical were analyzed. This paper evaluated the performance and the value of Kontour Medical. According to the dynamic change of the medical device industry, it also has given some comments and suggestions to the investors, especially about the government centralized procurements.

Keywords: Financial analysis, Risk, Kontour Medical.

1. Introduction

Medical device industry is relatively small to pharmaceutical industry in China right now, but the growth rate of this industry is very quick in recent years. Kontour medical Co., Ltd is one of the neuro implants companies which got listed in Shanghai Stock Exchange in 2021. I would evaluate the value of Kontour Medical by analyzing the key data of their financials and comparing the data with other similar companies in the industry.

In the past 30 years, China has made impressive gains in raising basic levels of health and healthcare expenditure is growing quickly. Medical device industry was growing with dramatic speed until the first cardiology centralized procurement which hurt most of the involved companies' revenue and profit in 2019. Some multinational medical device companies even left China market after centralized procurements. But the government is still keep increasing the investment in healthcare market and innovative products are encouraged by the government. I would like to evaluate some medical device companies' performance and their market value.

Wang analyzed 20 costal city enterprises, and used them to obtain the objective enterprise performance scores and rankings. Wang also provided a background for pharmaceutical industry. Wang explained the risk, assets, operating capacity, and growth capacity of that industry. After that, Wang used matrix and used the data to construct a model. The results show that Chinese medicine industry has large disparities at different levels but small disparities in the overall ranking [1]. Wang compared the two industry leaders of Medtronic and MicroPort Medical to study the structural differences in the high-value medical consumables industry. Wang compared the GDP of China and America and also used some other data to provide a background. Wang analyzed the demand for medical devices of the world, and did a graph of population vs age to illustrate why there were so many people that had chronic disease in China. Finally, Wang came to the conclusion that China had the potential for the development of medical devices due to the rising number of medical consumables [2]. Daryanto et al. did a financial performance analysis of pharmaceutical companies. Daryanto provided a context of previous financial performance of the companies. He analyzed many key data like ROE using tables to demonstrate the profitability conditions. After that, he did a several tests for the four companies. Eventually, he came up with a conclusion that Kimia showed a steady performance with minor decline, though in regards of profitability, liquidity and solvency performances. And also the potential market in the future will continue expanding as it reaches all social-economic levels of the Indonesian population [3]. Mansanga et al. evaluated the business

model of private health care companies in Zimbabwe. Mansanga provided background information for Zimbabwe health system and explained what a business model is. Mansanga made models and used questionnaires as the main method. Mansanga came up to a conclusion that the closest business model in use in private healthcare companies is the STOF model. The government also played an essential role in declining the health burden for medical companies [4]. Nie wanted to study the financial risk early warning by analyzing H company. Nie used tables to show the calculations and used the efficiency coefficient method to solve the enterprise financial early warning. Nie found out that the H company was in middle alarm in 2016-2020. The reason that the company had this level of risk was because the management didn't have enough risk awareness and foresight. In conclusion, H company was in moderate state of alarm and the model constructed in the paper could conform to the actual situation of the company [5]. Michaeli et al. did a valuation of Biopharma companies. Michaeli collected data and did estimations of the investment return of the companies. The study included a great sample size, which is a big advantage. The companies were valued higher when they were during preclinic. The final result was that company valuations were combined with previously published clinical development periods and success rates to estimate investment multiples and annual returns [6].

Yang wanted to use a method to detect falsified financial statement. He borrowed the UTADIS idea to detect the falsified financial statement of Chinese medical companies. He also used a matching method to calculate the cosine similarity. After that, several tables were introduced and they proved that the method they use would work very well since they did it by classifying financial ratio data into FFS and non-FFS groups in the paper [7]. Alali et al analyzed the financial performance of Moderna Inc for the past four years. Alali explained the importance of financial performance of a company and it is determined by the income statement, balance sheet and cashflow statement. The financial ratios were being criticized because they could be changed by the companies. What's more, the article was mainly based on secondary resource and the ratios were presented in a table. Moderna could improve their liquidity ratio by increasing the current assets. They should increase their equity and reduce the liabilities and increase the amount of cash in operating activities. Lastly, they should focus on their most promising projects [8]. Chen approached the evaluation of medical companies in a not prevalent way. He analyzed the macro environment, the industry overview and the overview of "Tong Ce". Then, he did other analysis of the data using tables and he analyzed revenue using formulas. He also calculated the WACC. Finally, his conclusion was that the dental industry was extremely fragmented in the future, the influx of capital brings competitors, and Tong Ce Medical should strengthen the control of sales costs [9]. Murayama et al demonstrated the financial relationship between pharmaceutical companies and the leading otorhinolaryngologists in Japan. They collected the name of all clinical practice guideline authors. They analyzed the payment data and evaluated the trends in payments per physician. The result was that 44.8% were paid of a total of \$13,873,562 and the median payment per physician were 0\$(interquartile range 0\$-851\$) for overall otorhinolaryngologists [10].

By analyzing the key financial data of Kontour Medical and comparing the data with some similar companies in the same industry, I would evaluate the performance and the value of Kontour Medical.

2. Kontour Medical Co., LTD

Kontour Medical Co., Ltd (Kontour Mecial) is a medical device manufacturer which is established in Xi'an, China in 2005. Kontour Medical is an established market leader in developing, manufacturing, sales, and distribution of titanium and PEEK cranial fixation solution for neurosurgery in China. Kontour Medical launched cardiac and dental implants in recent years. Kontour Medical began to expand the business out of China by acquiring an American cranial fixation company, Bioplate in 2017. Kontour Medical's business covers the United States, most of the European countries, Australia, Brazil, and most of the Asian countries. Kontour Medical invested in a US intra-cranial pressure monitoring company and a China dental company in 2021 and 2022

respectively. Kontour Medical was listed on Shanghai Stock Exchange in 2021. The key data of income statement is shown in Table 1.

Table 1. The key data of income statement

	2022	2021
Sales revenue	¥ 239,948,745	¥ 212,547,735
EBITA	¥ 88,464,531	¥ 95,392,571
Net Profit	¥ 74,170,348	¥ 81,182,491

Kontour Medical's sales revenue in 2022 is RMB239,948,745, with 12.89% growth Vs 2021. Kontour Medical's profit in 2022 is 74,170,348, with -8.6% growth Vs 2021. PEEK plate is an upgrade of the traditional titanium fixation system which is a golden standard for neuroplasty surgeries. It was launched in 2016 and becomes Kontour Medical's star product and it contributed 61.6% of the total sales revenue in 2022. The growth rate of PEEK products is 14.4%. Cardiac products' revenue is RMB 7,454K, with a 33.34% growth rate. Due to the "Zero Covid" policy restriction, most of the patients in China have many moving restrictions to go to hospitals and some hospitals were closed for some period in 2022. Many medical device companies were impacted and did not grow as robustly as before. The impact is significant to new products launch, such as cardiac and dental implant launches as very limited promotion programs can be organized during the pandemic in 2022. The Covid restriction was lifted at the beginning of 2023, and patients are free to see doctors wherever they want. And hospitals' surgeries numbers got fully recovered quickly in the first quarter of 2023. The key data of balance sheet (as of Dec 31st, 2022) is shown in Table 2.

Table 2. The key data of balance sheet

Cash and Cash equivalent	¥315,525,670
Accounts receivable	¥4,870,478
Current assets	¥352,696,771
Total assets	¥638,135,743
Current liability	¥46,967,770
Total liability	¥96,462,237
Total equity	¥541,673,506

Where, Current ratio is 7.51, quick ratio is 6.82. Kontour Medical just raised a big fund through IPO in 2021, and almost half of the company assets are cash or cash equivalent and the total liability is very small. All the indexes show that the liquidity of Kontour Medical is very good. But we do not know what the company is going to invest with such a big amount of cash. How to do investment with a big amount of cash is quite challenging. According to the company's annual report, the company is going to build a new building in 2023 to increase the manufacturing capacity, and some new products are being developed. Most of the new products being developed are neural and dental products.

3. The Opportunities and Risks of Medical Device Industry

The Medical Device industry is a relatively small industry, but very promising industry. There are strong barriers preventing potential players from entering the industry. It is very risky and usually costs a huge sum of money and a very long time to develop a new product. Making the plants qualified for manufacturing medical devices is also very time and money-consuming. It usually takes two to

four years to get a new product registered and get the license to sell. Medical devices are classified into 3 categories in China, Implants are classified as Class III products which means risky and have the highest registration requirement. Because of these barriers, the competition in this industry is not very fierce. The average life expectancy is getting longer quickly, especially in China. There will be more and more old people and more old people mean the average healthcare expense will continue to grow. The healthcare insurance coverage becomes bigger and bigger in China recently. That's why healthcare expenditure grows so quickly recently. The medical device industry is supported by the Chinese government and has been growing quickly in the past decades. It seems the healthcare expenditure grows quicker than the government can afford. China Medical Insurance Bureau began to have centralized procurements to control the price of most the medicine and many kinds of high-value medical devices. It significantly impacts the related industries and manufacturers. Some cardiology products had a 90% price reduction after the centralized procurement. It does benefit the patients and insurance companies a lot, but it is a disaster for some medical device companies. Some multinational medical device companies declared to leave China market after centralized procurement. Kontour Medical has two different tier products. Kontour (locally manufactured products) and Bioplate (manufactured by Bioplate) products addresses low-end and high-end market respectively. Having two different tier products is helpful as patients in different provinces in China have very different affordability and preference. Kontour Medical's star product, PEEK plates have many features and benefits for patients compared to traditional metal plates. Though PEEK material is very expensive, the penetration of PEEK plates increases quickly and PEEK plate is replacing titanium plate to become a golden standard for the Cranioplasty treatment. Kontour Medical grows rapidly by increasing PEEK plates penetration through surgeons' and patients' awareness education. But there are more and more competitors emerge in recent years, price becomes sensitive in some areas. And along with the market growth, it becomes big enough to get the government's notice. Centralized procurement of cranioplasty products including PEEK plates is coming. It may have a huge impact on Kontour Medical's profit. But because of the affordability increase after the price reduction, the volume of PEEK plate sold may increase. It may have little impact or even is helpful to Kontour Medical's sales revenue. According to Kontour Medical's report, more than 90% of the sales revenue is from neural products and from China market, which is very risky. One or two big policy changes may have big hurt to Kontour Medical. The dental implants business is mainly from private own hospitals and has much less impact by government and centralized procurement. International business is another way to mitigate the risks. The US market is the biggest market in the world and is still much bigger than the China market. But most countries require licenses for selling medical devices, international business growth is usually slow.

4. Financial Performance

As shown in Table 3 and Table 4, the gross profit rate and the net profit rate of Kontour Medical is 81.9% and 30.9% respectively in 2022. Medprint is a neuro products company which sell PEEK and other neuro implants. Double Medical is an orthopedics products company which sell titanium orthopedics and neuro implants. Among these three companies, Kontour Medical has the second highest gross profit rate and the highest net profit rate. It may attribute to its high market share in the specific market and high price of PEEK plates. Double Medical is with the biggest business size among three, but net profit rate is only 7.6%. It mainly because Double Medical has very high selling expense. And Orthopedics implants just experienced nationwide centralized procurement and it seems the net profit of Double Medical is impacted significantly. A very big concern is when the similar change will happen to neuro implants suppliers or PEEK implants suppliers. Kontour Medical has the highest return on equity which means Kontour Medical has high efficiency in using the assets. Considering Kontour Medical has a very small business size at this stage, how to maintain high return on equity is another challenge. Among these three companies, the R&D investment of Kontour Medical is the smallest.

Table 3. Profitability analysis

	Gross profit rate	Net profit rate	Return on Equity
Kontour Medical	81.9%	30.9%	14.64%
Medprint	85.2%	18.3%	6.08%
Double Medical	76.7%	7.6%	3.2%

Table 4. Key income statement data analysis

	Kontour Medical	Percentage to revenue	Medprint	Percentage to revenue	Double Medical	Percentage to revenue
Sales revenue	239,948,745		195,252,386		1,434,099,180	
selling expense	47,508,709	19.8%	70,273,232	36.0%	662,894,932	46.2%
admin expense	44,067,933	18.4%	35,298,729	18.1%	125,287,050	8.7%
R&D expense	18,301,085	7.6%	30,614,297	15.7%	256,717,036	17.9%
EBITA	88,464,531	36.9%	39,962,440	20.5%	147,458,784	10.3%
Net Profit	74,170,348	30.9%	35,734,918	18.3%	109,230,632	7.6%

All three companies have pretty low inventory turnover and high days sales of inventory. This may be due to medical device companies usually having high margins, and their products are not easy to be changed or they may need to report to government and change their licenses. They would not like to keep inventory low which will run a risk of having backorders. Backorders sometimes are disasters to medical device companies. It not only means losing profit, but also losing customers sometimes. According to the data, Kontour Medical manages the inventory best among these three companies. Since the customers of medical device companies are state-owned hospitals, they can always collect their accounts receivable. Most of the medical device companies have good days sales outstanding. Kontour Medical has the shortest days sales outstanding which means their capability to collect their accounts receivable is pretty good, as shown in Table 5.

Table 5. Operating ability analysis

	Inventory turnover	Days sales of inventory	Days sales outstanding
Kontour Medical	1.15	312.66	11.92
Medprint	1.23	291.59	14.51
Double Medical	0.4	893.52	96.51

Overall, most of the public medical device companies are able to generate cash well and stably, they have good ability to pay their debts. The solvency of Kontour Medical is the best among these three companies. All the indexes for that are the best among three, as shown in Table 6.

Table 6. Debt paying analysis

	Current Ratio	Quick Ratio	Debt Assets Ratio
Kontour Medical	7.51	6.82	15.1%
Medprint	2.91	2.49	19.1%
Double Medical	3.8	2.35	21.1%

5. Conclusion

Kontour Medical is an established market leader in developing, manufacturing, sales, and distribution of titanium and PEEK cranial fixation solutions for neurosurgery in China. By analyzing the financials of Kontour Medical and comparing the key data with some similar companies in the industry, we can see Kontour Medical has pretty good profitability, and Kontour Medical is with high

efficiency in operating and good solvency. The biggest concern to invest in medical implants companies recently is the impact from centralized procurements. While centralized procurements significantly eroded the sales revenue and profit of cardiology and orthopedics products companies. We can expect this will impact neuro products companies as well and only those companies with innovative products can survive. Since the R&D investment of Kontour Medical is not big, their investment direction is very important. Overall, Kontour Medical has pretty good financial performance in the past years and it seems their operating is with high efficiency. And their high market share will give them bargain power in the coming centralized procurement. We had better be prudent to the impact from centralized procurements which had big impact to all the related companies so far. But medical device industry will keep growing quickly and the government will keep investing in healthcare market.

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