

# Kangji Medical Holdings Limited

## 康基醫療控股有限公司

### (9997.HK)

#### Business Overview

Kangji Medical (“the Company”) is the largest domestic minimally invasive surgical instruments and accessories (MISIA) platform in China. Their mission is to enable physicians and improve health and wellness of patients through providing high performing and accessible products and services. The Company ranked first among all domestic players and fourth among all players (including international and domestic players) in China’s RMB18.5 billion MISIA market in 2019 by sales revenue, with a 2.7% market share, according to CIC. The Company also ranked first in multiple sub-segments of China’s MISIA market, including disposable trocars, polymer ligation clips, Class III disposable electrocoagulation forceps, and reusable trocar and forceps by 2019 sales volume, according to CIC.

The Company takes a demand-oriented approach to product development, with a focus on products with high market potential and that provide benefits in clinical practice. The Company offers a comprehensive product portfolio to provide physicians and hospitals one-stop and tailored surgical solutions primarily for four major surgical specialties (i.e. obstetrics and gynecology, or OBGYN), general surgery, urology and thoracic surgery). They believe their comprehensive and solution-oriented product portfolio can improve surgical efficiency and clinical outcomes for patients. Their broad product mix also helps them build brand loyalty with physicians and hospitals, realize synergies among their R&D, manufacturing and commercialization activities, and achieve economies of scale.

The Company engages with key opinion leaders (KOLs), physicians, hospitals and medical associations as a part of their academic promotion and marketing strategy, which enables them to establish a quality end-user base, especially with Grade IIIA hospitals with MIS capabilities. In line with industry practice, they primarily sell products to an extensive network of distributors covering all provinces, municipalities and autonomous regions in China. With their effective and extensive sales and marketing activities, hospitals in China purchasing our products through distributors increased from over 2,300 in 2017 to over 3,400 in 2019, among which Grade IIIA hospitals increased from approximately 770 to over 1,000. During the same period, their revenue derived from

#### Basic Information

##### Offer Price

HK\$12.36-HK\$13.88

##### Offer Size

225,397,500 Shares, comprise of Public Offer 22,540,000 Shares and International Offer 202,857,500 Shares (subject to reallocation and Over-allotment Option)

##### Market Capitalization

\$15,477 million to \$17,381 million

##### Application Period

16 June 2020 – 19 June 2020, Noon

##### Listing Date

29 June 2020

##### Board Lot

500 shares

##### Major Shareholders

Fortune Spring ZM B Limited	32.62%
Fortune Spring YG B Limited	18.49%
TPG Keyhole	19.96%
LYFE Capital Fund, L.P.	5.25%

##### Join Sponsors

Goldman Sachs, CITIC Securities, BofA Securities

##### Joint Bookrunners

Goldman Sachs, CITIC Securities, BofA Securities

domestic distributors increased from RMB213.8 million in 2017 to RMB307.9 million in 2018, and further to RMB450.9 million in 2019 at a CAGR of 45.2%.

Minimally invasive surgeries (MIS) remain significantly under-penetrated in China. According to CIC, in 2019, the number of MIS performed per million people and the penetration rate of MIS(1) were 8,514 and 38.1% in China, respectively, as compared to 16,877 and 80.1% in the U.S., respectively. Driven by the increasing number of surgeries, increasing substitution of open surgeries with MIS and improving accessibility of MIS in China, the number of MIS per million people and penetration rate of MIS in China are expected to increase to 18,242 and 49.0% in 2024, respectively. As a result, China's MISIA market is expected to experience tremendous growth, reaching RMB40.8 billion in 2024 at a CAGR of 17.2% from 2019. As the largest domestic MISIA platform in China, the Company believes they are well positioned to leverage favorable MISIA market trends such as the increasing usage of disposable products, growing acceptance of domestic products, product upgrades and innovation and market consolidation, and gain market share from their competitors, including international brands, in China's large and fast-growing MISIA market.

The Company takes a demand-oriented approach to product development, with a focus on products with high market potential and that provide benefits in clinical practice. The Company offers a comprehensive product portfolio to provide physicians and hospitals with one-stop and tailored surgical solutions primarily for four major surgical specialties (i.e. OBGYN, general surgery, urology and thoracic surgery). As of the Latest Practicable Date, the Company registered 41 Class I medical devices, 13 Class II medical devices and eight Class III medical devices in China. The Company has also developed a robust product pipeline to achieve a more extensive MIS product offering, including disposable ultrasonic scalpels, absorbable ligation clips and laparoscopic staplers to be launched in 2020 and 2021. See “— their Product Portfolio — Product Pipeline”, the Company believes their comprehensive and solution-oriented product portfolio can improve surgical efficiency and clinical outcomes for patients. Their broad product mix also helps the company build brand loyalty with physicians and hospitals, realize synergies among their R&D, manufacturing and commercialization activities, and achieve economies of scale.

The Company engages with KOLs, physicians, hospitals and medical associations as a part of their academic promotion and marketing strategy, which enables the company to establish a quality end-user base, especially with Grade IIIA hospitals with MIS capabilities. In line with industry practice, the Company primarily sells products to an extensive network of distributors covering all provinces, municipalities and autonomous regions in China. The Company generally operates a single-layer distribution system that enables efficient management and control and high visibility over market demand. In addition, the Company is highly selective in engaging distributors and has developed long-term and stable business relationships with most of their major distributors. With their effective and extensive sales and marketing activities, hospitals in China purchasing their products through distributors increased from over 2,300 in 2017 to over 3,400 in 2019, among which Grade IIIA hospitals increased from approximately 770 to over 1,000. During the same period, their revenue derived from domestic distributors increased from RMB213.8 million in 2017 to RMB307.9 million in 2018, and further to RMB450.9 million in 2019 at a CAGR of 45.2%.

Their business grew rapidly during the Track Record Period. Their revenue increased from RMB247.5 million in 2017 to RMB353.7 million in 2018, and further to RMB503.5 million in 2019 at a CAGR of 42.6%. Their gross profit increased from RMB199.7 million

in 2017 to RMB289.3 million in 2018, and further to RMB423.2 million in 2019 at a CAGR of 45.6%. Their gross profit margin increased from 80.7% in 2017 to 81.8% in 2018 and further to 84.1% in 2019.

## Financial Highlights

Summary of Consolidated Statements of Comprehensive Income						
For the year ended Dec 31						
	2017		2018		2019	
	in RMB thousands					
Revenue	247,506	100.0%	353,670	100.0%	503,467	100.0%
COGS	(47,801)	19.3%	(64,373)	18.2%	(80,292)	15.9%
<b>Gross Profit</b>	<b>199,705</b>	<b>80.7%</b>	<b>289,297</b>	<b>81.8%</b>	<b>423,175</b>	<b>84.1%</b>
Other income and gains	9,932	4.0%	36,171	10.2%	53,601	10.6%
Selling and distribution expenses	(11,826)	4.8%	(20,506)	5.8%	(41,355)	8.2%
Administrative expenses	(21,443)	8.7%	(28,493)	8.1%	(25,645)	5.1%
R&D	(10,477)	4.2%	(14,859)	4.2%	(17,377)	3.5%
Other expenses	(3,718)	1.5%	(449)	0.1%	(1,205)	0.2%
Finance costs	(1)	0.0%	(2)	0.0%	0	0.0%
<b>Profit before tax</b>	<b>162,172</b>	<b>65.5%</b>	<b>261,159</b>	<b>73.8%</b>	<b>391,194</b>	<b>77.7%</b>
Income tax expense	(23,695)	9.6%	(37,366)	10.6%	(64,459)	12.8%
<b>Profit and total comprehensive income for the year</b>	<b>138,477</b>	<b>55.9%</b>	<b>223,793</b>	<b>63.3%</b>	<b>326,735</b>	<b>64.9%</b>

## Use of Proceed

The company estimates that they will receive net proceeds of approximately HK\$2791.1 million after deducting the underwriting fees and expenses payable by them in the Global Offering, assuming no Over-allotment Option is exercised and assuming an Offer Price of HK\$13.12 per Offer Share.

- approximately 20.0%, or HK\$558.2 million, will be used to expand production capacity and strengthen manufacturing capabilities :
  - (i) approximately 9.8%, or HK\$273.5 million, to be used to expand production capacity of their current products and further automate existing production lines
  - (ii) approximately 10.2%, or HK\$284.7 million, to be used to build up production capabilities for pipeline products within the next six years
- approximately 25.0%, or HK\$697.8 million, will be used to fund R&D activities:
  - (i) approximately 17.0%, or HK\$474.5 million, to be used to establish an R&D center
  - (ii) approximately 8.0%, or HK\$223.3 million, to be used for development and expansion of their product pipeline
- approximately 20.0%, or HK\$558.2 million, will be invested in their sales and marketing activities
  - (i) approximately 15.0%, or HK\$418.7 million, to be used in their domestic sales and marketing activities
  - (ii) approximately 5.0%, or HK\$139.6 million, will be used to increase their overseas sales

- approximately 25.0%, or HK\$697.8 million, will be used to fund potential strategic investment and acquisitions within the next five years
- approximately 10.0%, or HK\$279.1 million, will be used for their working capital and general corporate purposes

## Cornerstone Investors

The following tables set forth details of the cornerstone placing and approximate percentage of total number of offer shares and percentage of total issued share capital of the company upon listing, based on different offer price scenarios.

Based on offer price of HK\$12.36				
Cornerstone Investor	Investment Amount (US million)	No. of share to be subscribed	Approx. % of the total offer shares	Approx. % of the total issued share after IPO
Fidelity Investments	45	28,218,000	12.50%	2.30%
BlackRock Funds	35	21,946,000	9.70%	1.80%
Lake Bleu Prime	25	15,675,500	7.00%	1.30%
Gaoling Fund, L.P. and YHG Investment, L.P.	15	9,405,500	4.20%	0.80%
Cormorant Global Healthcare Master Fund, LP	15	9,405,500	4.20%	0.80%
OrbiMed Funds	15	9,405,500	4.20%	0.80%
Oaktree Funds	15	9,405,500	4.20%	0.80%
<b>Total</b>	<b>165</b>	<b>103,461,500</b>	<b>46.00%</b>	<b>8.60%</b>
Based on offer price of HK\$13.12				
Cornerstone Investor	Investment Amount (US million)	No. of share to be subscribed	Approx. % of the total offer shares	Approx. % of the total issued share after IPO
Fidelity Investments	45	26,583,500	11.80%	2.10%
BlackRock Funds	35	20,674,500	9.20%	1.70%
Lake Bleu Prime	25	14,767,500	6.60%	1.20%
Gaoling Fund, L.P. and YHG Investment, L.P.	15	8,860,500	3.90%	0.70%
Cormorant Global Healthcare Master Fund, LP	15	8,860,500	3.90%	0.70%
OrbiMed Funds	15	8,860,500	3.90%	0.70%
Oaktree Funds	15	8,860,500	3.90%	0.70%
<b>Total</b>	<b>165</b>	<b>97,467,500</b>	<b>43.20%</b>	<b>7.80%</b>
Based on offer price of HK\$13.88				
Cornerstone Investor	Investment Amount (US million)	No. of share to be subscribed	Approx. % of the total offer shares	Approx. % of the total issued share after IPO
Fidelity Investments	45	25,128,000	11.10%	2.00%
BlackRock Funds	35	19,542,500	8.70%	1.60%
Lake Bleu Prime	25	13,959,000	6.20%	1.10%
Gaoling Fund, L.P. and YHG Investment, L.P.	15	8,375,500	3.70%	0.70%
Cormorant Global Healthcare Master Fund, LP	15	8,375,500	3.70%	0.70%
OrbiMed Funds	15	8,375,500	3.70%	0.70%
Oaktree Funds	15	8,375,500	3.70%	0.70%
<b>Total</b>	<b>165</b>	<b>92,131,500</b>	<b>40.80%</b>	<b>7.50%</b>



## Risks Factors

### Risks Relating to Business and Industry

- The Company may be unable to obtain, maintain or renew the regulatory filings and registration certificates needed to commercialize their products in a timely manner, or at all.
- The Company may not be able to maintain or renew all the permits, licenses and certificates required for their business and operations.
- The Company may fail to maintain or renew relationships with distributors, or further expand their network of distributors.

### Risks Relating to the Financial Performance

- Their historical operating results may not be representative of future performance.
- The Company has historically received government grants and The Company may not receive such grants in the future.
- The Company is subject to credit risk of their distributors, and their inability to collect on their trade receivables from their distributors may have a material adverse effect on their cash flows and operations.
- The discontinuation of any of the preferential tax treatments currently available to the company could reduce their profitability.

### Risks Relating to the Intellectual Property Rights

- The Company may not be able to protect their intellectual property rights.
- The Company may be unable to obtain and maintain effective patent and other intellectual property rights for their products and pipeline products, and the scope of such intellectual property rights obtained may not be sufficiently broad.
- Their patent rights relating to their products and technologies may be found to be invalid or unenforceable

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