

JCAP

STAAR Surgical (STAA)

August 11, 2020



Office of Shanghai Qinghong, owned by the chairman of STAAR's China distributor, Lansheng. Company is in a village 60 km from the city center and has the same phone and website as Lansheng.

Contrarian Investor Conference 2020

8/10/20

STAAR derives 53% of its global revenue (Q2) from a single distributor in China called Lansheng.

- ▶ We think STAAR's China sales are overstated by at least 33%. That would mean NONE of STAAR's profit actually exists.
- ▶ Fake sales come at 100% margins and therefore translate directly into profit.
- ▶ That means that the roughly \$21.6 mln in overstated Chinese sales in 2019 represent 152% of total company profit.



STAAR Surgical makes Implantable Contact Lenses (ICLs) to treat severe myopia.



The ICL is a niche product that competes with LASIK but is far more expensive. Insurance does not cover the procedure.



STAAR has lost money in 13 of the last 17 years.



STAAR got 43% of its income and 71% of growth in 2019 from a single distributor in China (whose name the company misspells).

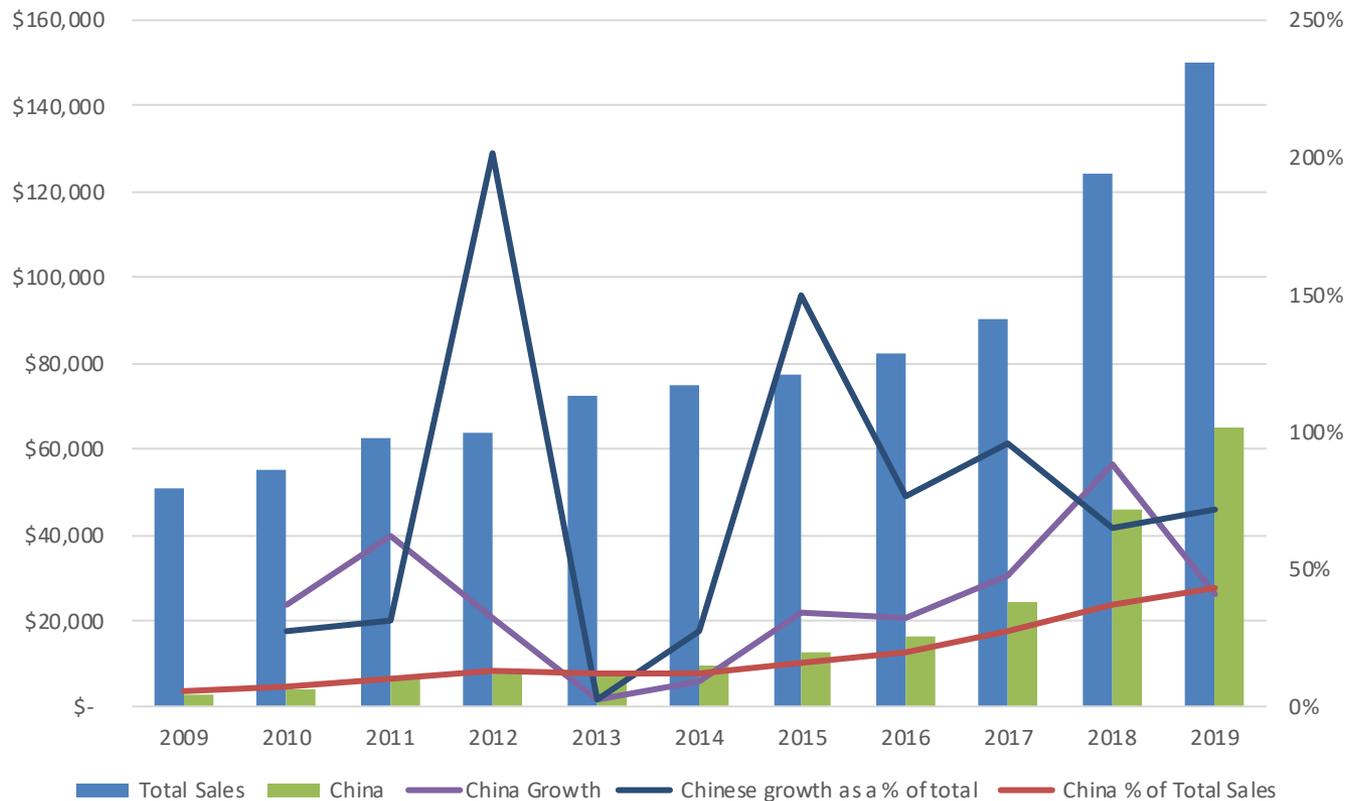
Ex-China, STAAR sales have grown an average of 5% annually for the last decade.

Ex-China STAAR Sales (mln USD) and YoY Growth

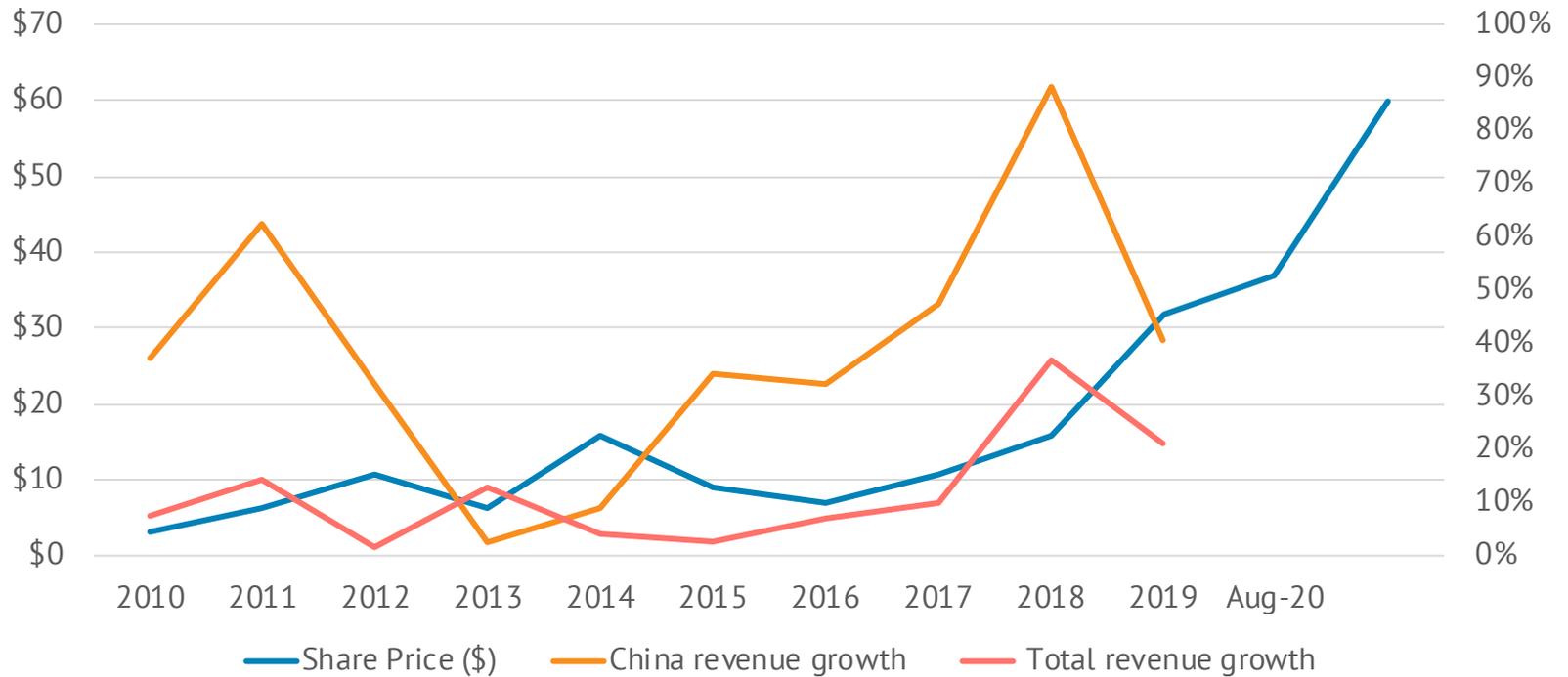


Source: STAAR disclosures

China CAGR has been 37% for a decade.



The China market has provided all the growth and has supported a skyrocketing share price.



Source: STAAR disclosures

Some key milestones have marked the share gains: signing the Chinese distributor and giving a “strategic partner” its own account that bypasses the usual ordering system.

Lansheng starts as exclusive distributor; strategic cooperation with Aier announced.



Who is the China distributor, Lansheng?

- ▶ Privatized portion of a Shanghai SOE.
- ▶ The company owner formed a new company that he called by the same name in English though it's written differently in Chinese. He moved the STAAR business to his new company. It has a BVI parent where ownership is opaque.
- ▶ Owner is shareholder or director of about 26 medical companies
- ▶ The sub-distributors also own clinics

Lansheng 1: the registered office, on Shanghai's Chongming Island.



Lansheng 2: office in downtown Shanghai.



Photos by J Capital and J Capital investigator spring 2019

Our evidence

1. The largest customer: Aier Eye Hospital Group (300015 SZ) buys less than distributors claim.

- ▶ Aier represents half of China sales. The volume should have been about 70,000 lenses in 2019.
- ▶ But the Aier 2019 AR shows about ¥617.9 mln spent on ICL procedures. At roughly ¥30,000 per procedure, that translates into 20,596 procedures.
- ▶ If every procedure involves two lenses, that's 41,192 lenses. That's only a bit more than half of what it should be to make up the numbers.



2. Lansheng uses 8 Tier 2 distributors. We spoke with them all. Numbers don't add to reported totals.

Company Name	Number Sold in 2019	Note
Shanghai Leyue Optical Equipment Co., Ltd.		Owned by former STAAR staff. No staff or physical presence.
Guangzhou Shiran Medical Equipment Co., Ltd.	3,000	2019 sales rose by 30%
Beijing Jiashikang Technology Co., Ltd.	8,000	
Changsha Tianzhi Medical Equipment Co., Ltd.	12,000	
Shanghai Qinhong Trading Company		Owned by Lansheng owner. No staff or physical presence.
Shenyang Wanli Road Technology Co., Ltd.	500	"Very low sales"
Shaanxi Shangbo Trading Co., Ltd.	1,800	
Chongqing Shangzhou Medical Devices Co., Ltd.	2,750	
Total Inventories	1,000	
Total Lenses	29,050	

Source: J Capital Research

- ▶ Two of the Tier 2 distributors are shell companies with no visible activity.
- ▶ The other six together told us they had sold about 29,400 lenses in 2019.
- ▶ Together, the estimated Aier sales and sales to other channels add to 70,400 lenses. That is more than one-third short of the volume necessary to generate the reported China revenue of \$64.8 mln.

Two of the distributors appear to be empty shells.



Left: Shanghai Leyue is owned and managed by former STAAR China staff. When we called, the company refused to confirm its name or address or to let us speak with a salesperson. Lansheng claims that Leyue sells 20% of China product. Above: Qinghong is owned by Zhang Jian, the owner of Lansheng. Its phone and website are the same as Lansheng's and it has no visible staff.

Photos by J Capital July 2020

3. Swiss trade data and activity don't compute.

Schweizerische Eidgenossenschaft
Confédération suisse
Confederazione Svizzera
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Results table

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9021.9000 - Articles and appliances, which are worn or carried, or implanted in the body, to compensate for a defect or disability, and parts and accessories of articles and appliances of heading 9021 (excl. artificial parts of the body, complete hearing aids and complete pacemakers for stimulating heart muscles)

Period ¹	Commercial partner	Export			
		Quantity (kg)	Quantity +/- %	Value (CHF)	Value +/- %
January 2018	China	490	4.0	1,223,215	22.6
February 2018		661	-6.9	1,360,839	-6.1
March 2018		741	32.3	1,554,299	10.4
April 2018		733	2.8	1,511,490	18.3
May 2018		1,081	90.3	2,272,525	93.1
June 2018		1,086	110.1	2,729,251	109.9
July 2018		1,231	150.7	2,322,649	211.4
August 2018		1,683	140.4	3,067,457	76.3
September 2018		908	59.0	1,778,406	12.3
October 2018		1,006	125.1	1,916,076	54.7
November 2018		990	27.9	1,546,457	-24.0

- ▶ Swiss export records show just \$23.5 mln in exports of implantable contact lenses to China for 2019, compared with STAAR's reported China sales of \$64.8 mln. The exports to Hong Kong are de minimis.
- ▶ 100% of China product is shipped from Switzerland.

Source: Swiss-Impex

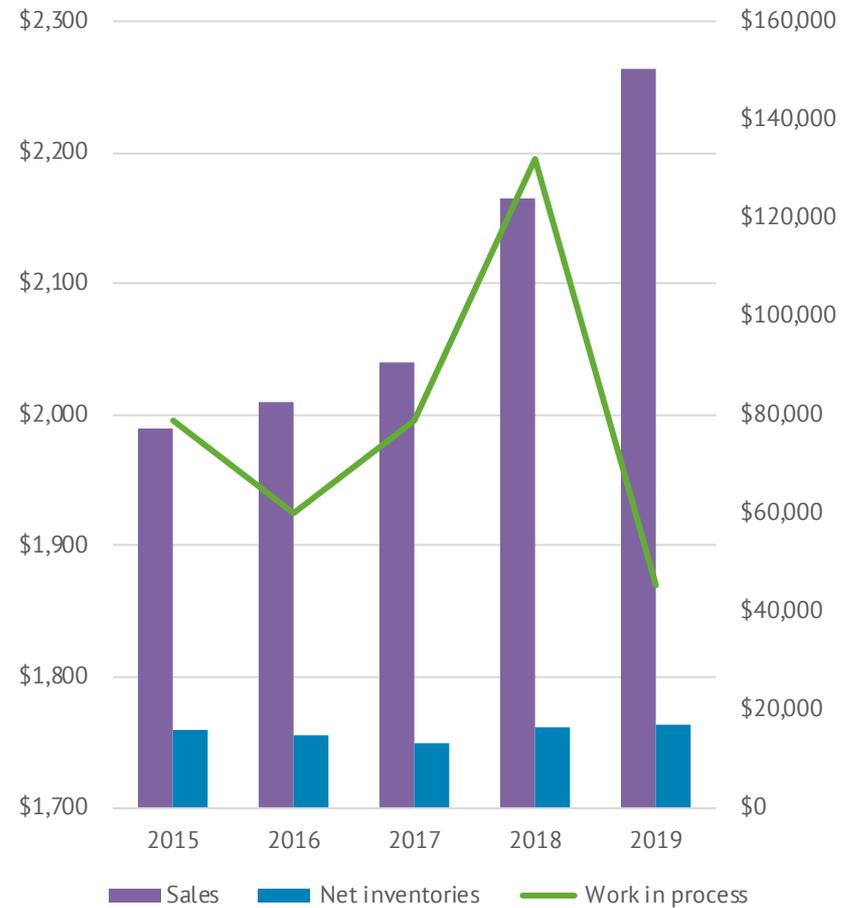
STAAR has been renting a facility in Nidau for two decades. But despite sharp increases in volume, neither headcount nor space has grown.

STAAR facility in
Nidau,
Switzerland.
Photo by J Capital
July 2020



4. STAAR's accounts are hard to reconcile with the story of a rapidly growing manufacturer.

- ▶ Inventories have actually declined over five years despite a 95% increase in income. Work in process has declined 6% in five years, falling every year except 2018.



Cash taxes remain puzzlingly flat despite nearly tripling of profit.

Cash Taxes and Net Profit (,000 USD)

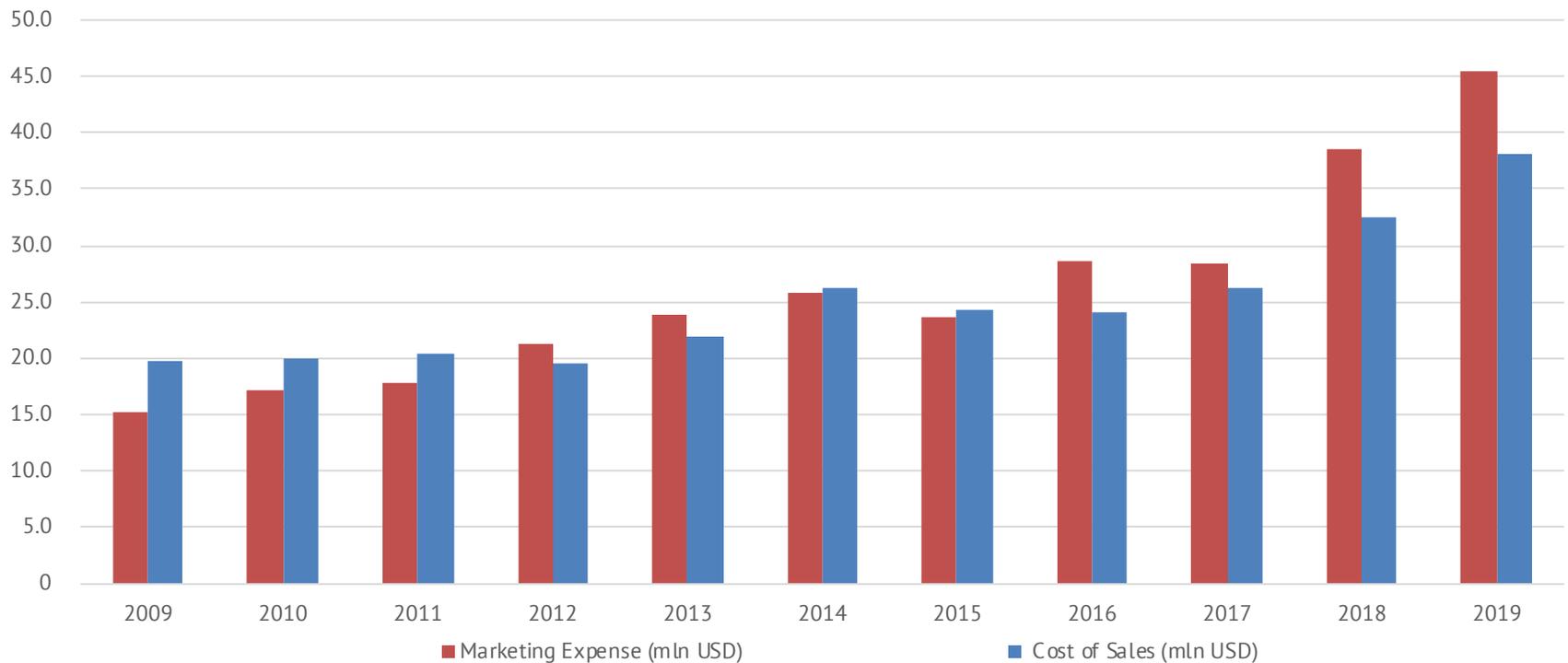
	2017	2018	2019
Cash taxes paid	\$ 881	\$ 635	\$ 792
Net income	\$ (2,139)	\$ 4,968	\$ 14,048

The company has also reported no growth in VAT receivable over five years despite very significant growth in sales in international markets where VAT returns are accrued.

H1 results

- ▶ Asia and especially China rescued H1 results. Although sales declined by 2.7%, China went from 43% to 53% of total company sales. ICL volumes were reported up by 7%.
- ▶ But this information conflicts with what we were told by Lansheng, its Tier 2 distributors, and 15 clinics. They estimated that volumes had declined in H1 by 30-50%.
- ▶ We asked about market inventory and found inventories were light.

How to generate fake turnover 1: marketing budget



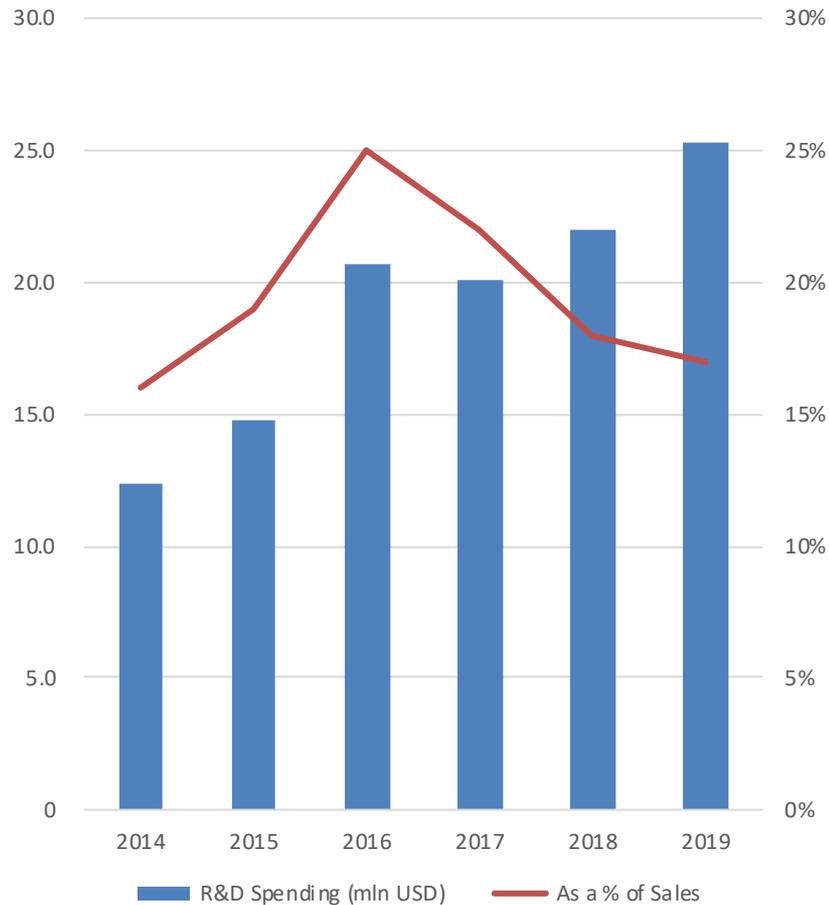
Using marketing to inflate sales?

- ▶ We think about half of the \$45.5 mln marketing budget may be used to inflate sales by overstating price and booking the inflated amount as a marketing expense.
- ▶ Former executives say a big chunk of the budget is dedicated to “price subsidies” for the lenses, eg, a lens really sells for \$300 but STAAR books \$450 and adds \$150 to “marketing expense.”

We cannot find anything approaching \$45.5 mln in actual marketing spend.

- ▶ Local distributors pay for any advertising
- ▶ STAAR pay honoraria for conferences and training. But we could identify maximum \$500,000 annually in those expenses.
- ▶ Based on local financial statements, STAAR China spent less than \$200,000 on sales and marketing in China in 2019, yet China is 43% of the total market.

How to generate fake turnover 2: R&D budget



- ▶ We are skeptical of the reported \$25 mln in 2019.
 - Interviews say all R&D is internal
 - Company has ~20 staff in R&D.
 - Quality remediation may have cost up to \$3 mln annually 2014-18 but is completed now.
 - Trials run through contract research organizations: ~\$3 mln annually
 - About \$15 mln in R&D appears unaccounted-for

STAAR's total clinical trials: few and far between

STAAR Clinical Trials

Title	Status	Year Completed	Estimated enrollment	Locations
Prospective Comparative Study of Refractive Outcome of STAAR and Alcon Toric Intraocular Lenses	Completed	2010	100	Singapore, 1 location
Rotational Stability After Nanoflex Collamer Toric Intraocular Lens Implantation in Astigmatic Patients	Unknown status	2017	60	Italy, 1 location
Randomized, Prospective Comparison of the Outcome of Toric Implantable Contact Lens (TICL) and Q-LASIK for the Correction of Myopia With Astigmatism	Unknown status	2008	30	China, 1 location
Clinical Performance of a Phakic Intraocular Lens (IOL)	Completed	2019	41	Belgium, Spain: 5 locations
Rotational Stability of V4C Toric Implantable Contact Lenses After On Axis Implantation Measured With OPD Scan 3	Unknown status	2018	75	Korea, 1 location
Endothelial Cell Loss After Penetrating Keratoplasty	Completed	2020	8	Egypt, 1 location
Multicenter Clinical Trial of a Phakic Implantable Collamer Lens (ICL)	Recruiting	2023	333	U.S., 14 locations
Comparative Analysis of the Visual Performance After TICL Implantation in Patients With Stable Keratoconus	Unknown status	2016	24	Tehran, Iran, 1 location
Prospective Evaluation of Near and Intermediate Visual Outcomes With Monofocal Intraocular Lenses: The Mast Study	Unknown status	2012	200	U.S., 1 location

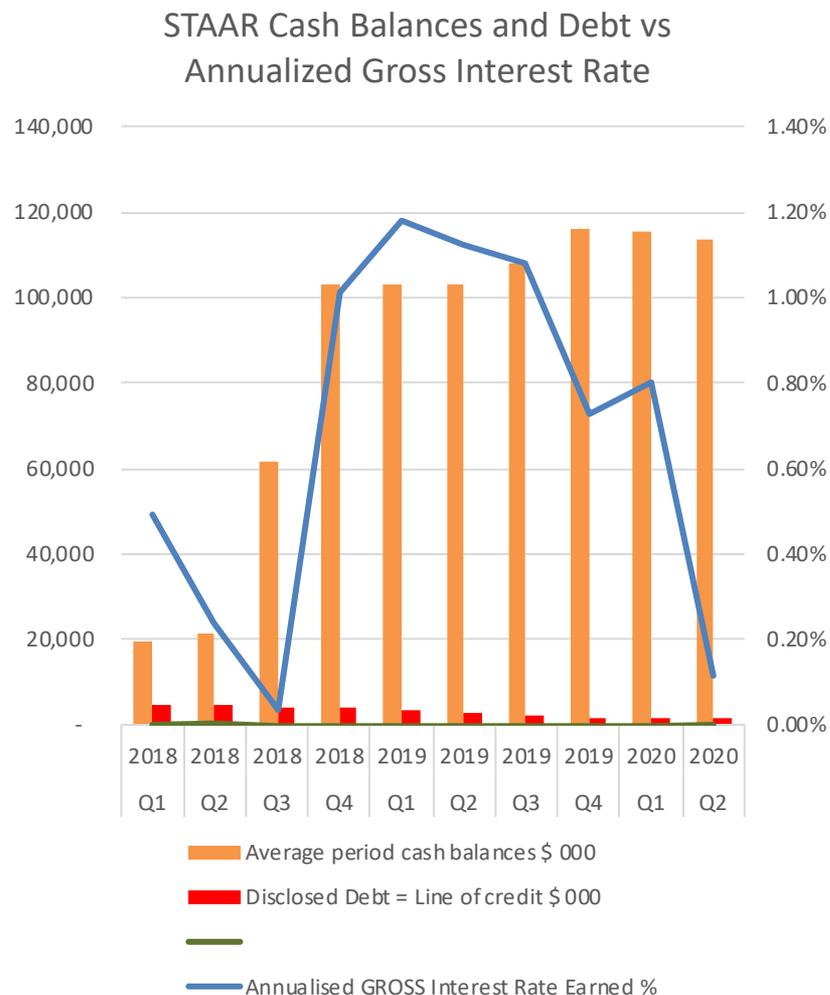
Source: <https://clinicaltrials.gov/ct2/home>



Source: clinicaltrials.gov

Weird cash pattern

- ▶ STAAR's Q2 report showed that the company earned almost no interest on its large cash balance of \$116 mln--\$20,000 net.
- ▶ This is a net number, but debt is tiny, at \$1.3 mln.
- ▶ The company in May 2020 issued a shelf offering, which is odd, since STAAR is sitting on more than 5x as much cash as it ever had prior to the secondary offering in 2018.
- ▶ We are hesitant to accuse any company of misleading investors about cash balances, but this is not right.



FDA deficiencies

- ▶ STAAR has a pattern of lying to investors and regulators. The company paid out \$10.7 mln to settle two separate class-action lawsuits over a decade
- ▶ Both of the lawsuits alleged that STAAR hid from investors deficiencies found by the FDA in STAAR's management processes.

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