

# The Independent Analyst's Report

**INTERPORE INTERNATIONAL (Nasdaq:BONZ)**

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KEY STATISTICS			
Recent Price:	12 1/2	P/E: (TTM)	40.19
52 Wk Range:	\$ 3.875 - \$ 14.25	Yield:	NA
Market Cap (Mil):	169.10	Avg. Volume (000's)	190.3
Shares Outstanding (Mil.):	13.5	Float (Mil.):	5.3
Investment Opinion:	Strong Buy	Price Objective:	\$21.00

Interpore Cross International is a medical device company that makes spinal implant devices and synthetic bone and tissue products. The company significantly increased its focus on the spine market, one of the fastest growing areas within the orthopedic marketplace, with its merger with Cross Medical Products in May 1998. Interpore Cross products fall into two categories: bone biologics and spinal implants.

Sales by Product Segment (millions)	1997	1998	1999
Bone biologics product sales	\$13.8	\$14.8	\$18.0
Spinal implant product sales	\$12.9	\$15.4	\$20.8
Dental product sales	\$1.7		
Total net sales	\$28.4	\$30.2	\$38.8
% of Sales by Product Segment	1997	1998	1999
Bone biologics product sales	49%	49%	46%
Spinal implant product sales	45%	51%	54%

- Bone Biologics Products:** The bone biologics products are comprised of coralline-based bone graft substitute products, OEM hydroxyapatite products, and products for collecting growth factors to encourage bone growth.
- Spinal Implant System:** The Spinal Implant System consists of rods, hooks and screws that are attached to vertebrae adjacent to an injured or defective area of the spine. The surgeon restores the natural anatomy and the system stabilizes the patient's spine while fusion of two or more vertebrae occurs. A bone graft material is typically used in a spine fusion surgery, and the implanted spine system helps to prevent the bone graft material from collapsing or migrating during fusion.

## Situational Analysis

The market for bone graft materials and spinal implants is significant, and is estimated to be approximately \$1 billion per year worldwide.

The number of bone graft procedures performed annually in the United States is estimated to exceed 500,000. This includes a wide variety of procedures, with approximately 53% of the procedures in the spine, 33% in other orthopedic procedures, and about 14% in maxillofacial applications.

In addition, the number of spinal fusion procedures performed annually in the United States is estimated to exceed 300,000. Spinal implant devices are used by surgeons to obtain fusion of vertebrae in areas of the spine affected by degenerative diseases, deformities, trauma and tumors. Spinal implants are used to restore the natural anatomy and stabilize the spine while fusion occurs, and they assist in preventing the bone graft material from collapsing or migrating.

## Financial Highlights:

OPERATING DATA: (in thousands, except per share)	1996	1997	1998	1999	2000(E)	2001(E)
Net sales	\$28,489	\$28,429	\$30,209	\$38,856	\$49,396	\$60,873
Cost of goods sold	9,497	9,110	8,552	11,645	14,684	18,078
Gross profit	18,992	19,319	21,657	27,211	34,713	42,795
Operating expenses:						
Research and development	2,688	3,220	3,650	4,192	5,336	6,567
Selling and marketing	12,689	11,575	11,826	13,978	17,097	20,296
General and administrative	4,019	4,683	4,035	4,351	5,335	6,353
Non-recurring expenses		617	5,017			
Total operating expenses	19,396	20,095	24,528	22,521	27,767	33,217
Income/(Loss) from operations	-404	-776	-2,871	4,690	6,946	9,578
Total other income/(expense)	324	566	506	515	688	856
operating income or loss	-80	-210	-2,365	5,205	7,633	10,435
Income tax provision (benefit)	-788	-2,119	59	407	2,366	3,235
Net income (loss)	\$1,939	\$4,379	-\$2,424	\$4,798	\$4,881	\$7,200
Net income (loss) per share	\$0.15	\$0.33	-\$0.17	\$0.35	\$0.36	\$0.51

## Financial Performance and Valuation Summary

For the fourth quarter ended December 31, 1999, net sales were \$10.7 million, a 31% increase compared with net sales of \$8.2 million for the same period last year. Sales of spinal implant products, primarily the Synergy™ Spinal System, increased by 34% to a record \$5.6 million in the fourth quarter versus \$4.2 million in the fourth quarter of 1998. Sales of bone biologics products, primarily Pro Osteon® bone graft substitute material and AGF™ (Autologous Growth Factors) associated products, increased 28% to a record \$5.0 million in the fourth quarter from \$4.0 million in the same quarter of 1998. Operating income before provision for income taxes more than doubled to \$1.6 million for the quarter ended Dec. 31, 1999 versus \$788,000 in the same quarter of 1998. Net income for the fourth quarter of 1999 increased by 57% to \$1.2 million, or \$.09 per diluted share, compared with \$788,000, or \$.05 per diluted share, for the fourth quarter of 1998.

The company began a national launch of AGF™ (Autologous Growth Factors) in 1999 and of AGF associated products in the fourth quarter exceeded \$1.1 million, a sequential increase of more than 50% from the third quarter of 1999. AGF is a platelet-rich plasma derivative providing growth factors from the patient's own blood that enhance bone growth and healing. Initially introduced to the orthopedic market, AGF has been gaining growing market acceptance in the wound healing and sealant areas.

## Investment Outlook

Interpore shares have been in a nice upward trend since the breakout in January when the stock moved through some heavy resistance near the \$8 level, accompanied by a solid increase in volume. The technical indicators are also moving sharply higher, with the momentum indicators looking very strong and the stochastic indicators treading in overbought territory, which are technical patterns indicative of a strong upward trend.

The fundamental business outlook for Interpore also appears bright, with the company experiencing better than 30% year over year growth in sales for each of the past three quarters. The company has been gaining market share in the spinal implant product market, experiencing a 35% growth last year. In addition, the bone biologics products grew a solid 22% in 1999, led by sales of the AGF (Autologous Growth Factors) associated product sales. The spinal implant market and the orthobiologics market continue to be two of the most rapidly expanding areas in orthopedics, and the company appears well positioned to take advantage of the growth in this market.

This stock appears to be attractively valued at current prices, trading at about 24.5x projected fiscal 2001 earnings. In addition, after several years of underperformance, the whole healthcare sector appears to be gaining momentum and we believe that with the improving operating results, and the company's focus in the two areas within orthopedics market, Interpore appears to be well positioned for continued growth into 2000 and beyond. Based on the positive fundamental outlook and strong technical pattern, we are rating the stock a strong buy with a 12 - 18 months **price objective of \$21** per share.



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