Taking Stock: Wound-care developer is a healthy company

by Malcolm_Berko

Dear Mr. Berko: What can you tell me about Kinetic Concepts? A friend, who had diabetes, would have had to have his foot amputated, but for Kinetic Concepts new wound treatment. The physician who treated him told us that this new wound care treatment is covered by my friend's insurance policy, which I find incredible. I am thinking about buying a large number of shares for several trusts I administer and would appreciate your impression of this company and its potential future successes.

B.W.

San Antonio

Dear B.W.: Kinetic Concepts Inc. (KCI-$62.06) is right in your lovely backyard on the 8000 block of Vantage Street, which is several blocks from your office. And KCI's new CEO, Kathy Burzik might treat you to lunch if you give her a ring. She doesn't fit the image of a chief executive officer; her enthusiasm, her intensity and her relentless drive will leave you dizzy. This lady is a class act.

KCI shares came public in February of 2004 at $30 when revenues were $560 million and the stock literally thundered to $79 by year's end. The driving force behind KCI's future is its revolutionary surgical healing and tissue-repair therapy used in hospitals around the world.

This high-tech wound- and tissue-repair treatment is called vacuum-assisted closure, or VAC. The system uses nonabsorbent foam, which is applied to the surgical site or wound and covered by a transparent membrane. Air is sucked from the trauma area surrounding the foam via a vacuum, creating a "negative pressure that hastens healing, prevents infection and lessens scarring." While VAC costs more than old-fashioned gauze dressing by a factor of 20, studies show that quick wound repairs so significantly lowers costs that VAC is competitive with the outdated gauze-and-tape method.

The wound-treatment market is growing by bounds and leaps. Casualties from the Mideast, Iraq and Afghanistan - along with diabetic skin ulcers, accidents, increased surgical procedures and the treatment of certain viral infections - are increasing dramatically. The U.S. military recently approved Kinetic's VAC on medical evacuation flights.

VAC is, by orders of magnitude, enormously superior in every way to gauze and tape, and KCI owns a 90 percent share of the market. There's tremendous room for growth because 90 percent of wound care still uses the low-tech, barbaric gauze-and-tape dressing. Three surgeons whom I know and who use this system believe that VAC, in a dozen years, will be used by 50 percent of the hospitals in the U.S. And it should, considering that healing and closure time can be reduced by 50 percent to 75 percent.

KCI is a $1.4 billion company, VAC products account for 75 percent of revenues, which should grow to $2.5 billion in the coming four years. Earnings in 2006 of $2.60 a share may double to $5.20 in the next four years while current free cash flow of $4.10 a share could top $8 by 2011 or 2012. Those are mighty impressive numbers.

Meanwhile, Burzik has developed strong ties with hospitals, nursing homes, home-care providers as well as superb relationships with health insurers who have widely embraced the VAC product. These relationships have enabled KCI to easily dominate the negative-pressure wound-care therapy market in the U.S. Its only competitor (Blue Sky Products) generated a dinky $55 million in 2006 revenues. Kinetic is now looking to expand its business in China and Asia and is in the process of completing a series of clinical trials in Japan. In the coming dozen years, these countries should add impressive numbers to KCI's revenues and earnings per share.

The shares trade at a respectable 17 times earnings, and the company has plenty of cash with which to finance various smaller acquisitions and continue its spending on research and development. Jeffries & Co. as well as Deutsche Securities recently upgraded KCI to a "buy" with a 2007 target price of $60. J.P. Morgan's Michael Weinstein gives KCI a solid five-star ranking. This should please the officers and directors who own 26 percent of the stock. And current shareholders should be mighty pleased to know that so much of the stock is owned by those who manage the company. That's called management confidence.

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