I have a position in this security at the time of posting and may trade in and out of this position. This is not a recommendation for anyone to purchase or sell this stock. Please do your own research.

Idea:	Long – Lensar Inc. ("LNSR")
Market Cap:	$87mm
Price:	$7.30 (12/22/2020)

Forced selling makes LNSR prime to re-rate when shareholder rotation is complete.

As a bit of background, PDL Biopharma ("PDLI") spun-off LNSR in October as part of its liquidation. Passive and quant holders of LNSR have been selling the stock as it no longer falls within their mandate. This is evident as the top holders of PDLI, who would have had to file a 13-G (Blackrock, DFA, Rentech), haven't; these three funds account for almost 20% of the shares outstanding. Furthermore, most PDLI investors have been playing the sum of the parts story through the liquidation. Taking into account other passive (Vanguard, State Street) and long only funds who are likely not holders of a <$100mm market cap cashflow negative company, it's fair to assume that at least ~40% of shareholders have been sellers. It's also fair to consider tax loss harvesting as we head into end of year. This rotation and selling pressure should reach an end shortly as ~60% of shares distributed have traded cumulatively.

LNSR is a commercial-stage medical device company that sells a femtosecond laser system for the treatment of cataracts ("FLACS"). Last year there were 29mm cataract surgical procedures globally. The vast majority (97%) of these are done through manual incisions followed up by ultrasonic phacoemulsification (delivering energy into the eye to break up the cataract) or extracapsular cataract extraction (removal of lens). The remaining 3% is done with FLACS which consists of a laser to make the cuts prior to the phacoemulsification. Cataract surgeries are expected to grow at 3% through 2024 while FLACS should gain share and grow at 5%.

There are several reasons for FLACS paltry market share. Most notably, it is a premium product that requires an investment on behalf of ophthalmologists and cash pay on behalf of customers. This explains why penetration is so much higher in wealthier nations (11% in the United States). Furthermore, there is still a debate on the value proposition of FLACS in comparison to manual incisions. One point of differentiation, however, is FLACS superior outcome with regards to astigmatism – LNSR provides a lot of data around this in their investor presentation. Personal feedback from practicing ophthalmologists have indicated that while the cuts from FLACS are "beautiful," the extra time it takes to set up the machine and cost make it less attractive at this point. As such it is hard to underwrite a dramatic increase in market penetration based on outcomes. Nonetheless, there is reason for optimism. Reimbursement rates in the United States for traditional cataract surgery fell 15% in 2020 down to just $557, and are expected to drop again. Continued pressure on reimbursements may lead ophthalmologists to further embrace the premium alternative.

LNSR has just 13% market share within the FLACS industry, while eyecare behemoths Alcon and J&J Vision hold 39% and 24% share respectively. As a small player LNSR has made the strategic decision to go after doctors who are already using a laser, rather than expend their resources on expanding the pie (leave that to the big guys!). FLACS represents a relatively small business for Alcon / J&J and LNSR has been able to steal share by providing a more advanced system and customized pricing based on volume and the doctor's aspirational goals. LNSR grew their installed systems by 13% in 2019 and are up 6% so far this year. LNSR procedures have historically grown at ~30% a year though are down so far in 2020 given Covid disruptions.

The company is running with an elevated R&D budget as it develops its next gen ALLY system. ALLY is designed to be a 2 in 1 system that offers traditional phacoemulsification and FLACS. The benefits of ALLY to LNSR are obvious. It opens up a very large market for LNSR, allowing the company to sell to doctors who have historically been averse to laser. There are currently 56k phacoemulsification machines in the field versus just 2,500 FLACS.

More importantly, ALLY obviates some of the concerns around set up time and efficiency as I alluded to before. Today FLACS machines are separate from phacoemulsification requiring multiple patient set-ups with the patient having to move from one room to another during the procedure. Because ALLY is fully integrated, it cuts down on these unnecessary steps. LNSR conducted a study of 122 surgeons regarding ALLY and found that 40% said the use of a dual system would increase the number of FLACS procedures they perform and 83% said they would consider acquiring a dual function system. LNSR is sitting on $43mm of cash which it says is enough to carry them through ALLY launch in H2 2022.

Revenue comes from the sale or lease of FLACS systems, ongoing system service, and product / per-procedure fees – a razor / razor-blade model. For the YTD period recurring revenue represented 87% of total. Prior to the spin management guided to 20% annual revenue growth and "$40mm range" in 2022. At that revenue level LNSR is trading at just 2.4x. This obviously excludes any credit for ALLY which should kick in the following year.

While Alcon trades at 3.9x 2022 revenue, it is a mature $35bn company that has slower growth. STAAR Surgical is a better comparison, though it is admittedly a higher quality entity (they provide implantable collamer lens as an alternative to LASIK and intraocular lenses that are used in cataract surgery). STAAR trades at 13.6x and is forecast to grow revenue in the high 20% range.

LNSR is run by Nicholas Curtis who has been with the company since 2012. He previously was a founding member of Chiron Vision which was sold to Bausch & Lamb. He subsequently founded Refractive Surgical Resources which was acquired by Laser Vision Centers. He also worked for 6 years as a senior vice president of sales & marketing at STAAR. LNSR employees own 15% of the company.

Down the road an acquisition by a larger player is not out of the question.

At Alcon's multiple LNSR is worth almost $13 a share (+65%). At 5.0x it is $16 (+110%). LNSRs own internal valuation as part of the PDLI spin was a bit over $11 (+45%).