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# Integra Thinks High Margin, Differentiated Portfolio Can Deliver A Transformative 2017

by Ashley Yeo

Integra LifeSciences surged to industry-leading 12% sales growth in 2016, and that's before it prepares to consolidate two of the biggest acquisitions in its history. What is the strategy behind the success of the specialty surgery, orthopedics and tissue tech company that is looking at another double-digit sales uplift in 2017?

*Integra LifeSciences Holdings Corp.*has been pleasing the market with its 2016 financial performance, 2017 M&A schedule and 2017–18 outlook. At some point, the group aims to reach aspirational targets of $2 billion in sales and 30% EBITDA margin as it establishes itself as a diversified medical technology group.

Its M&A has been making most of the headlines, but as Integra president and CEO Peter Arduini told investors on the February 23, 2016, results call and Q+A, organic growth in fact supplied 9% of the group's 12.4% growth in 2016, adding over $100 million to the top line and finishing 2016 a shade under a billion dollars, at $992.1 million.

[Integra LifeSciences]' relationship to its parent 's current success is down to at least three differentiating factors that distinguish its approach to the market from that of its competitors: sales strategy in advanced wound care, laser-focused M&A targeting and deriving business synergies from diversified group elements.

And 2017 will see the group continue to bend the curve upwards, with the largest acquisition activity of its 28-year history. An all-cash $7 per common stock share tender offer for advanced wound and burn care and tissue regeneration company *Derma Sciences Inc.* closed on February 22 with a majority of acceptances; and fourth-quarter 2017 will see the $1.045 billion purchase of *Codman Neurosurgery*from *Johnson & Johnson*'s *DePuy Synthes* unit. *[See Deal][See Deal]* (Also see "*Integra Aims To Bolster Neurology Portfolio With J&J Codman Buy*" - Medtech Insight, 16 Feb, 2017.)

Perhaps Arduini was understating it when he said, "We look forward to a transformative 2017 as we integrate two of the largest acquisitions in the company's history." With 2016 adjusted EBITDA for the full year of $231.7 million (2015, $195.6 million), and adjusted net EPS up from $1.54 to $1.76 per diluted share, these are good moments for the Plainsboro, NJ, group in its new structure comprising two reporting segments: specialty surgical solutions and orthopedics/tissue technologies.

On top of this, it has extended its credit agreement – in two ways: up to $1.5 billion and out to the year 2021. This will be used to fund the $204 million purchase of Derma Sciences, a company that will add scale to Integra in the advanced wound care market. Codman – adding a complementary advanced hydrocephalus, neuro-critical care and operative neurosurgery portfolio and the Codman brand to Integra's specialty surgery business – will be funded by cash held outside the US, a new term loan and existing credit facilities.

Arduini said Integra had achieved the many goals it had set for itself in 2016, and its efforts have seen it clearly outpace the average mid-single-digit growth of the medtech industry as a whole. The group CEO believes Derma Sciences caps off 2016 as a watershed year for Integra's advanced wound care strategy, and sets it up for accelerated growth as of second-half 2017.

## Factor 1: The Advanced Wound Care Unique Sales Proposal

This upbeat outlook is partly down to the group's "3x3" wound care strategy – now enhanced with the addition of Derma's amniotic and placental tissue products – a sales concept that saves reps from burning time by not having to cover wide geographies. Essentially, Integra's reps are offering three products through three sales channels, and using a triple strategy. This is one of the elements that differentiate Integra's business model. The group says it is the first to employ this concept (*see box*).

Integra gained PMA approval for *Omnigraft* for diabetic foot ulcers in early 2016 – and it is so far the only product with a label to regenerate tissue. It also in-licensed the *VolTAC* wound dressings for pressure, venous and diabetic ulcers, first and second degree burns, and surgical incisions and/or graft recipient sites. Dural repair – where Integra's industrial origins in collagen repair lie – was a challenging market in 2016, but the business still yielded high-single-digit sales.

### *The 3x3 strategy*

Integra's 3x3 allows its reps to offer:

- The products: Omnigraft – engineered collagen matrix; PriMatrix – acellular dermal matrix; and (via the Derma purchase) AmnioMatrix – human amniotic tissue.
- Via the sales channels: inpatient,

So 2017 begins with 90 Integra reps focused on outpatient advanced wound care channels. Pro forma 2016 advanced wound care sales reached around $50 million – that is expected to grow by 20% to $60 million in 2017 with the full-year consolidation of Derma Sciences. Five new regen med products will come on-stream in 2017.

### Factor 2: Selective Targeting Of High-Growth Ortho Opportunities

In all, the ortho/tissue technologies business segment, which includes wound care, saw a 21.5% increase in sales in 2016 to $359.6 million, a huge rise owing to selective M&A as well as organic growth.

outpatient and enterprise (early, high-level engagement to craft unique value offerings).

- Using strategic approach options tailored to: multiple clinical options (products for multiple wound types and severity), multiple channels (accessing top surgeons who work in both outpatient and inpatient settings) and corporate contracting (a broader contracting option offering a product range to serve wider system needs).

Last year's ortho revenues were impacted by the October 2015 acquisition of US rights to Tornier Inc.'s *Salto Talaris* and *Salto Talaris XT* ankle replacement products; and to its *Futura* silastic toe replacement products for $6 million. [See Deal] This accelerated Integra's entry into the US total ankle replacement market. The Tornier agreement also includes an option to purchase rights to these products outside the US. That may yet happen in 2017, but the earliest effects of than transaction on sales would be second-half 2017.

This deal was preceded by agreements in July 2015 to buy TEI Biosciences Inc.and TEI Medical Inc. for an aggregate net cash payment of $312.4 million. [See Deal][See Deal] TEI Bio develops biological devices for soft-tissue repair and regenerative applications, including dura and hernia repair and plastic and reconstructive surgery. TEI Med holds a license to TEI Bio’s regenerative technology in wound healing and orthopedics.

A big year of targeted M&A concluded in December 2015 with the $14.1 million acquisition of the assets of Italy's Tekmed Instruments SpA (neurosurgery, neurotrauma, plastic and reconstructive surgery), which has boosted Integra's specialty surgery business.

Elsewhere in ortho, Integra already has a total shoulder system and a reverse shoulder. It continues to develop a *pyrocarbon hemishoulder*, but is waiting to see how it plays out in clinical work. Integra appears to be less committed to the upper extremities market, perhaps in view of the big competition.

But in lower extremities, Integra sees good synergies with its regen med pipeline – in tendon and ligament repair. It predicts opportunities in these segments over the next two years, and is targeting a top-four position in all its chosen subcomponents. It says it will expand its extremity efforts in 2017, and in first-half 2017 will add more sales reps.

Its *Cadence* total ankle replacement was launched in 2016, and with the acquired Salto Talaris, Integra has a broad market offering. Company management says it "feels good" about its US ankle prospects, owning "a world-class portfolio in a hot market with two of the best products out there," in Arduini's words. It is also working on a revision product, and with this trio of offerings, the group sees itself as well positioned to capture share in this growing market.

## Factor 3: Synergies From Diversified Platforms

On the surface, diversified product mixes may appear to lack focus, but Integra plays its portfolio for both its differentiating and synergistic factors, and this is another element in the group's current run of success. The selling platforms of the two reporting segments (orthopedics and tissue technologies, and specialty surgical solutions) contribute differently to the Integra whole.

Specialty surgical solutions provides a solid presence in the hospital, with market-leading products and comprehensive solutions for surgical specialties, such as neurosurgery. It provides strong capacity to generate cash flows. Ortho/tissue tech helps Integra grow the top line by allowing it to continue to introduce new, differentiated products in fast-growing markets, such as small joint replacement and advanced wound care. This increases gross margins. And synergies can be leveraged between these and the regen med, instrument sourcing and enterprise contract management activities.

## Codman Addition Boosts Integra Outlook And OUS Aspect

Integra's specialty surgical business yielded sales of $632.5 million in 2016, up by 7.8%. Codman, which will come into this segment, hits on many of Integra's strategic tenets – as well as providing the needed international scale. It also gives brand, and expands Integra in the US and global neurosurgery markets.

Neurosurgery is a core expertise of the Integra segment, and is predicted to give the group global reach for years to come. Like Derma, Codman will be slightly dilutive to Integra's top-line growth, but post-integration, the group will accelerate the growth of both businesses, and will also introduce new specialty surgery products in 2017. Both acquisitions will transform Integra's global scale, reach and profitability, Arduini believes, while organic growth will be driven by new products and investments.

Early feedback to Integra about the Codman move has been positive, the CEO stresses. Employee reaction and the general dialogue both seem positive. Arduini sees a merged entity that can innovate and enhance the OUS business, noting that "going from $200 million revenue to $400 million revenue makes international that much more relevant to the company." On the regulatory side, the US FTC filing had not delivered its feedback as of end of February, but specialty surgical has become a very competitive industry with four large players.

In all, Integra expects its 2017 sales to be in the range $1.12 billion to $1.14 billion – a 12.5% to 15.5% reported increase, and organic sales to grow by 7.5% to 8.5%. At present, the group expects $1.88 to $1.94 adjusted EPS in 2017, and double-digit adjusted net income growth. Arduini is "confident of being ahead" of the group's 25% EBITDA gross margin target for 2018.

Integra's tissue ablation and neuro critical care activities are predicted to increase their sales in the range of 3.5% to 5.5%, with tempered expectations in dural repair and precision tools and instruments. Ortho and tissue technology as a whole will see 9% to 14% growth on an organic basis. There will be room to make more commercial investments focused on ortho/tissue technologies, and in international channels.

From this, it appears that Integra is well on target to deliver a transformative 2017 and establish the foundation stones that will help the group meet a long-term target of 6% to 8% organic sales growth.