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Medtechs Weigh Up Preferred Growth Strategies As Pandemic Tails Out

Spin, divest, M&A? Medtechs Will Be Delving Deep Into Their Strategy Toolbox In 2023

by **Ashley Yeo**

Medtech M&A was at a decade low in 2022 and IPOs was a closed market, says EY life sciences partner John Babitt, who gave his thoughts on likely strategic activity in the year ahead to *In Vivo*.

Spin outs and restructuring plans have been plentiful at the top end of the medtech industry in the past year. The focus on portfolio pruning for long-term growth has become very visible as the industry exits more confidently from the COVID-19 pandemic.

As 2022 ended, so 2023 continued on the theme of spin outs. [*GE HealthCare Technologies, Inc.*](#)'s pre-announced spin was completed on 3 January, and the company's stock rose by over 27% in the period to 30 January. (Also see "[*GE HealthCare Stretches To The Next Level*](#)" - In Vivo, 5 Jan, 2023.)

Institutional investors are interested in companies that can present a cohesive long-term strategy, EY life sciences partner John Babitt said in comments to *In Vivo*.

For big medtech, the motivating factor is the need to figure out what will be truly strategic looking ahead three, five or even ten years, said Babitt. While some companies have succeeded in adjusting portfolios, others are struggling to execute on this in the post-COVID period. At the same time, all of them are aware of smaller companies exhibiting double-digit growth.

While the markets are still pandemic-disrupted to a certain extent, any decision on changes required to secure long-term growth comes as an additional complexity for an industry braced



EY'S JOHN BABITT: "EXPECT MORE SPINS AND ASSET SALES IN 2023"

for another year of unusual business patterns.

"The dilemma for big companies is which high-growth markets to over-allocate capital to" – John Babitt

Last year saw an unprecedented combination of negative high-level trends. In a new EY blog, Babitt recounted in 2022 that: medtech M&A activity decreased to its lowest levels in a decade; the IPO window was essentially closed; companies saw dips in stock prices; and there was a decrease in financing

across the industry.

More positively, medtech M&A opportunities may emerge in the second half of 2023.

In the meantime, the dilemma for big companies is about which high-growth markets they want to allocate – preferably even “over-allocate” – capital to. “We’re seeing a lot of that kind of thinking, and different strategies as a result,” Babitt said.

Companies are intent on achieving a capital structure that allows them to double down on some of the larger bets—those that they see as being more strategic over the long term. Companies that have been divesting are aiming to hit these higher growth markets.

“Medtech is an industry that requires innovation in order to be really successful in the end markets. If a company cannot allocate the appropriate amount of capital to develop a competitive product, it may be that it will decide that someone else is the better owner of that asset.”

Simplifying, Reducing Complexity

Simplifying the business structure will help companies focus on bigger, perhaps clearer, priorities. [Medtronic plc](#) is this year preparing to separate its respiratory and patient monitoring businesses—and CEO Geoff Martha indicated that more plays of this kind might follow. In 2021, these two activities brought Medtronic revenues of \$2.2bn – enough to create a global top 50 company in its own right.

[Philips Healthcare](#) CEO Roy Jakobs during the company's 2022 Q4 and annual sales and earnings call also emphasized a need to reduce complexity and simplify his company's approach to the markets. Philips has had a tough year on the quality front, with recall actions adding to the supply chain and other headwinds that medtech as a whole has been experiencing.

However, M&A/divestment is not part of the Philip's Healthcare's strategy to fully recover its competitive position.

Another company talking about simplifying its business to achieve more growth is [Baxter Healthcare Corp.](#). Recently, it announced a division of its business, entailing the separation of the kidney care activities.

This can be read as a change in how Baxter wants is to organize itself going forward. For the company that paid \$12.2bn in 2021 to acquire connected care and smart beds company [Hill-Rom Services Inc.](#), it is a statement about where it sees its strategic future.

"Hill-rom is part of the long-term Baxter strategy and will continue to be front and center, while it believes other adjacent businesses may be better owned and attract incremental investment if owned by someone else," Babitt said.

Spin Fever Prognosis: More To Come

Spin outs were also seen in 2022 at [Zimmer Biomet Holdings, Inc.](#) and [Becton, Dickinson and Company](#), and [3M](#) announced a long-term value creation plan through spinning off its health care business (wound care, oral care, healthcare IT and biopharma filtration) in a transaction to be completed before the end of 2023.

The preceding year, [Johnson & Johnson](#) announced it would create a "leaner, new J&J" by splitting off its consumer division (now renamed Kenvue), which would operate as a standalone company. The remaining J&J medtech and pharma businesses work under similar regulatory and competitive environments.

Babitt said: "J&J has been very disciplined about its portfolio and about what makes sense long-term. It has been making big strides." In December, the company completed the \$16.6bn acquisition of [Abiomed, Inc.](#). This is probably the clearest indication of incremental capital allocation to longer term strategic priorities.

"There's a general appetite to fund medtech, even in times of a

recession”

Some of these strategic portfolio rebalancings are rooted in management’s knowledge that a company cannot do everything – at least, cannot do everything *well* – and that there are faster-growing markets to be exploited in and across medtech, Babitt told *In Vivo*.

It is a fact that major medtechs have often been assembled over multiple years by multiple acquisitions and been integrated to a certain extent, but not fully, he added. “What COVID exposed was a lack of centralization and integration in a number of instances, as seen in earnings releases bemoaning supply chain weaknesses.”

For all these reasons, more spinouts and sales of medtech assets can be expected in 2023.

Industry Dynamics For 2023

Babitt launched EY’s 2023 [*M&A Firepower*](#) report, aimed at life sciences companies intent on maximizing dealmaking values, at the 41st JP Morgan Healthcare Conference in January. EY also used the forum as another opportunity to go deeper into the findings and perspectives of its 2022 [*Pulse of the Industry*](#) – the 16th annual edition.

These publications, and Babitt’s [*blog*](#), provide insight on the current dynamics of the medtech industry, summarize facts and trends and delivering observations on the direction of a global industry where public medtech company revenues surpassed \$500bn in 2021. He writes that:

- the acute impact on procedure volumes arising from talent retention difficulties has provoked financial challenges across health systems;
- foreign exchange headwinds and inflation are putting pressure on the bottom line; and
- on the private equity front, investors appear to be more focused on portfolio value creation to prepare companies for exit next year, after the market has thawed

but also that:

- medtechs are expressing cautious optimism for 2023, with some raising their 2023 forecasts above 2022 levels;
- a flat IPO market in 2022 might mean a backlog of pending high-quality IPOs involving

attractive private companies;

- the combined business headwinds might in fact lead to M&A opportunities in the second half of 2023; and
- medtech innovations continue to emerge with “dazzling speed”

As You Were...For A While Yet

However, the business and operating conditions as experienced by medtechs in early 2023 are expected to continue through the first half of the year, Babitt adds. Specifically, these relate to:

- major forex headwinds for US-based medtechs that report in US dollars, shrinking their sales and gross margins;
- tremendous pressure on wage costs, even in low-cost jurisdictions like Mexico and China, where wage costs are up by 30%. Babitt stressed: “The rising cost of wages is not transitory, but a step-function increase in cost”;
- increased raw materials and electricity costs; and
- fluctuating transportation costs – but here, a reversion to near normal is ongoing.

Other factors impinging or buoying business, or where there are needs to address, include:

Inflation

Inflation has been tough on medtechs. Most observers expect the current inflationary pressures to continue this year and in 2024. Many companies are addressing gross margin/operating margin prospectively because of the impact on performance, which is naturally a big issue for institutional investors.

Some companies have considered marginal price increases prices of 1-2%, or slightly above; but prices take time to work through. Many contracts are longer term, and they may or may not have cost-of-living increases built in.

Residual COVID Effect

Because of heightened awareness of the value of in vitro diagnostics and innovation following COVID-19, Babitt observes that a decent amount of venture funding is still going into

diagnostics.

This is split largely two ways, being target either at: sophisticated tests such as liquid biopsies, where several projects have been funded; or diagnostics that can be used at home. At present, reimbursement is sticking, but there is a fear of a reversion to the pre-COVID reimbursement climate, which would not be good for product coverage.

At-Home Care

More companies are now bidding to deliver care to the patient at home, which is generally the patient's preferred place for this. Amid this trend, US providers are now observing that inpatient care is migrating to ambulatory surgery centers (ASCs), and ASC work is moving into the home. "We expect those trends to accelerate."

Automation Investment Opportunity

Staffing levels at hospitals has been a major issue of late, in and outside the US. While US physician/surgeon numbers are seen as adequate, and providers are now witnessing the nurse shortage situation slowly coming under control, there remains a real difficulty in getting staff to do the low paid, non-specialist jobs.

Often it is the lack of such staff that leads to the cancellation of procedures, and cost consequences for hospitals. There is an opportunity for automation of tasks such as these, such as assembling device kits for the OR, automated dispensing at the pharmacy or perhaps robots used in the delivery of patients' meal trays to the bedside.

Confidence In Industry's Agility

Referring to current market trends at AdvaMed's Medtech Conference in fall 2022, Babitt expressed confidence in medtech's prospects going forward, despite the economic challenges. "There's a general appetite to fund medtech, even in times of a recession," he said, adding a prediction that the industry will navigate the upcoming challenges with agility.