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Orthopedic Industry Exhibits Steady Transactional Activity and Value, Despite Maturity

Investors and entrepreneurs in recent years have gravitated away from orthopedics and medtech in general, toward splashier, hyper-growth subsectors of the life sciences, such as biotech and digital health. Outcome Capital argues that the industry—and ortho in particular—remains highly attractive, as it offers investors and entrepreneurs stability, healthy multiples, and opportunities for innovation.

► Wendy Diller

In recent years, many investors have pigeon-holed orthopedics as a lackluster, mature sector dominated by a handful of large companies that are under relentless pricing pressures, with little to show for product differentiation.

As the biotech and tech sectors have boomed, that assessment seemed to hold merit, at least judging from stock price trends. Outcome Capital LLC, an investment bank specializing in the life sciences sector, compiled stock indexes comparing different life sciences sectors based on a range of small, mid-sized, and large public companies. The indexes show that over the last 12 months (LTM) the biopharma index rose 12.1% and the diagnostics subsector index rose 10.6%,

whereas life sciences services were up only 0.5% and medtech, including ortho, rose only 0.4%.

Those figures, however, overlook some compensatory features and compare orthopedics unfairly with high growth, but much more volatile, alternatives, according to Outcome Capital. Its data shows that leading orthopedic companies' market caps have been stable for the past five years and that deal volume has been steady, reflecting a healthy market, despite the pandemic's disruptions and a slowdown in medical procedures, says Oded Ben-Joseph, PhD, managing director at Outcome.

"The sector is not growing 20% year on year, but every year it has a handful of M&A deals and solid financings," he says. Also reflecting the industry's health, the average EBITDA multiple in the segment rose during the pandemic, despite decreased earnings and is now back to pre-COVID multiples.

By far the most deal activity took place among middle market companies with revenues ranging from \$50 million to \$250 million, says Ben-Joseph, noting that, "Orthopedics has at least half a dozen or more highly attractive deals in the middle market space each year, and during COVID-19 the pace rose, even when voluntary procedures were declining." Between 2019 and year to date 2022, deal volume involving middle market companies totaled 18, compared with nine in the under \$50 million category and only six involving companies larger than \$250 million. The most deals took place in 2020: 16 during the early stages of the pandemic, with 10 taking place in 2019 and 11 in 2021.

In short, Ben-Joseph notes, the orthopedic sector is characterized by stability; healthy, stable multiples; and opportunities for value-enhancing innovation, particularly around minimally invasive surgery (MIS) and digital technologies. Market leaders in orthopedics are strategically focused on fortifying their positions in MIS as more

surgeries move to the outpatient setting, and there is a growing demand for implant technologies that promote reduced recovery time and improved patient outcomes. These companies are also prioritizing digital systems and enabling technologies that optimize surgical workflows for MIS and are differentiated in a commoditized market (see Figure 1).

In terms of asset preferences, about half of orthopedics deals in the past three years involved companies with diversified orthopedic portfolios (general), while a quarter involved spine surgery pure-plays, and another quarter of the deals involved joint reconstruction specialists. Few deals—about 10% in the past three years—were centered on pure-play orthobiologics companies. That segment is too small, so niche players looking to sell their companies will likely need to fine-tune their value propositions by building out their portfolios in a step-by-step roll-up strategy, he notes.

The Outcome Capital analysis found that although valuation multiples are declining from 2021, they still exceed LTM multiples from March 11, 2020. The abnormally high stock performances through 2020 and 2021 due to COVID-19 skewed multiples from March 11, 2020, but discounting that period, reinvestment into product lines and implementation of digital technologies in a traditionally commoditized market are enhancing the value of orthopedic players.


Looking ahead, the firm predicts that orthopedic players will likely continue to be aggressive dealmakers as they employ inorganic growth strategies, and that M&A targets providing digital assets and integration will likely be valued at a premium compared with others. 

Figure 1
Orthopedic Market Leaders:
Strategy Overview from Earnings Calls Q4 2021

Earnings Call Date Company	Key Takeaways
1/25/22 JNJ DePuy Synthes	Focus on flexibility/reduced stiffness for enhanced patient outcomes Integrating with digital surgery/robotics
2/17/22 Globus Medical	Robotic surgery system (<i>ExcelsiusGPS</i>), primary growth driver, demand for both robot and consumables Anticipate launch of <i>ExcelsiusGPS</i> ecosystem to provide seamless experience for surgeons
2/22/22 Medtronic	Launching new spinal implants to enhance value of preop planning software, imaging navigation, and robotic systems Bolstering powered surgical instruments for spine procedures
2/23/22 NuVasive	Expanding into minimally invasive surgeries and bolstering markets where not previously a leader Invest in comprehensive, integrated platforms that provide flexibility to treat all pathologies with any procedure <i>Pulse</i> platform launched in 2021; software system that integrates multiple technologies into a single platform Next-gen <i>Pulse</i> platform to be released Q2 2022
2/22/22 Smith & Nephew	Adding to <i>CORI</i> robotic and digital surgery platform is strategic priority Rolling out porous knee implant with <i>CORI</i> platform Next-gen shoulder implant promoting bone preservation and simple, MIS procedures is key to growth Bolt-on M&A
1/27/22 Stryker	M&A for meaningful, differentiated assets Category leadership across business lines Spine robotics in development
2/7/22 Zimmer Biomet/ ZimVie	ZimVie spinout completed 3/1/22 Focus spine on MIS, motion preservation, and enabling technologies Expand core spinal fusion product suite

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Source: Outcome Capital, 2022; Corporate earnings calls