July 04, 2017

Startling reversal of fortunes as large-cap medtechs soar

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Happy days are here again. The first half of 2017 has brought more good news than bad for large-cap medtechs, and compared with the dismal atmosphere of 2016 there is a distinct improvement in sentiment (see tables).

It is possible that the medtech industry is benefiting from looking like a safer place for investors than the biopharma sphere. There is still little clarity on what the new US healthcare laws might mean for either sector, but politicians are certainly more exercised about drug prices than about the costs of medical devices.

The difference with previous years is clear in the performance of the healthcare and medtech indices. Across the board this is the best showing since *EP Vantage* started tracking them four years ago. Despite promises of sweeping legislative changes on both healthcare and tax reform in the US having failed – so far – to result in anything concrete the US-listed medtech stocks are going gangbusters.

Stock index	% change in H1 2017
Thomson Reuters Europe Healthcare (EU)	17%
Dow Jones U.S. Medical Equipment Index	25%
S&P Composite 1500 HealthCare Equipment & Supplies	25%

Investor confidence appears to have returned in a big way in Europe too – the recent flurry of IPOs in Stockholm is an indication of this. The Eurozone is well into recovery mode, and while the ramifications of Brexit will take some years to become clear it seems likely that any downside will be borne by the UK rather than an admittedly slightly shrunken EU.

Teenage angst

Almost all of the disorders diagnosed or treated with medical devices are more common in older patients: they are the ones who need hip implants, heart valves or cancer tests. But the big cap company which has seen the biggest rise in its share price over the first half of 2017 has a different section of the population to thank: teenagers.

Align Technology makes Invisalign, a range of devices for straightening uneven teeth without using the unsightly wires we all remember with a shudder from our schooldays. The technology is not covered by Medicare, but neither is any other orthodontic treatment, and when it comes to private insurance Invisalign and more traditional wired braces see similar coverage.

Patients can therefore often choose for themselves the type of teeth-straightening technology they want to use – and Align has a sophisticated advertising operation on TV and social media specifically targeted at teenagers. In the first quarter of 2017, 49,000 teenagers started treatment with Invisalign in North America, up 31.6%, which was more than the company had expected.

Align's new range, Invisalign Teen, is not even approved yet in the US. According to *EvaluateMedTech*'s consensus data, this is forecast to grow at 23% between 2016 and 2022, by far the company's fastest-growing segment.

Intuitive Surgical has had its ups and downs in the past but 2017 has been all up, at least so far. The faster than expected US clearance of its mid-range da Vinci X robotic surgery system helped (*X marks the spot for Intuitive, May 31, 2017*).

Hospitals that buy Intuitive's systems naturally want to wring the most value they can out of their hefty investment; Intuitive's flagship machine costs around $2m. So they use the device to perform as many surgeries as possible – and Intuitive makes a killing here too, as it sells instruments for the system that are either single-use or wear out frequently. Its instruments and accessories segment accounted for more than half its revenues in 2016 and is the fastest-growing part of the business.

Large cap ($10bn+) medtech companies: top risers and fallers in H1 2017				
	Jun 30 share price	**H1 chg**	**Jun 30 market cap ($bn)**	**H1 chg ($bn)**
Top 5 risers				
Align Technology	$150.12	56%	12.06	4.40
Intuitive Surgical	$935.37	47%	34.46	9.89
C. R. Bard	$316.11	41%	22.95	6.44
The Cooper Companies	$239.42	37%	11.70	3.16
Baxter International	$60.54	37%	32.91	8.80
5 worst performers				
Sysmex	¥6,710.00	(1%)	12.71	(0.88)
Olympus	¥4,100.00	1%	12.75	(0.57)
Terumo	¥4,425.00	3%	15.25	(0.52)
Essilor International	€111.40	4%	26.08	0.26
Philips	€31.10	7%	31.36	1.67

In 2015 five big-cap medtech stocks fell in value; last year there were no fewer than nine large medtech fallers. This year there was just one. Sysmex is Japan's top laboratory testing company, and is the global leader in blood cell count testing. In May the company missed its revenue targets for the fourth quarter, and by quite a bit: analysts from Credit Suisse wrote that at ¥5.1bn ($45m) for sales and ¥3.2bn for operating profit "the scale of the shortfall was much larger than we expected".

National trends are also partly to blame. Where all the risers in the first half are US-listed companies, the top three worst performing companies are Japanese. Faced with a demographic problem – nearly 30% of the Japanese population is aged 65 or older – the government has been working hard to limit medical costs.

Analysts from Jefferies wrote that stricter standards on payments by the Social Insurance Medical Fee Payment Fund, a Japanese medical expenditure regulator, were continuing to reduce testing volume, and this affects Sysmex to a greater degree than it does the other big-cap Japanese medtechs, which are involved in the imaging, ophthalmics or cardiovascular areas.

So, while young people are buoying Align's stock, it is the preponderance of elderly people that has pushed Sysmex's lower.

The story of the first half of 2017 is clearly one of recovery, with a resurgence of the healthcare markets in both Europe and the US. But turbulence could lie ahead. Next week the final form of the American Healthcare Act ought to be unveiled, and if it passes the next item on the agenda will be tax reform. Either of these might boost the pharmaceutical sector, resulting in shareholders jumping ship from medtech.

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