

Smaller cap medtech firms thrive on takeovers but suffer in court



[Joanne Fagg](#)

The first half of 2013 was a dismal time for mergers of device companies, but during the second half things started to pick up, and the two small cap medtech companies that saw the biggest growth in their share prices did so thanks to being taken out towards the end of the year (see table).

At the other end of the spectrum, Sequenom led the small-cap fallers. The company has had a difficult year financially and was also hurt in November when a patent underpinning its Down's syndrome test was disallowed. This was related to wider changes in the way IP covering genetic testing technologies is viewed in the US, and the sector has changed, and will continue to change, rapidly.

Buyouts and activist investors

The top small cap riser in the second half of last year, Mako Surgical, in fact no longer exists as a separate concern; its acquisition by the orthopaedics giant Stryker for \$1.65m was completed on December 17 ([Stryker takes a stride into the future with \\$1.65bn Mako buy, September 26, 2013](#)).

There had been a great deal of concern over robotic surgery, with some of the larger systems being associated with poor outcomes, particularly considering their enormous cost. Mako, with smaller, more specialised equipment, defied the naysayers, with the shares up 35% from the mid-year point even before Stryker made its move.

Small cap (\$250m-2.5bn) medtech companies: top risers and fallers in H2 2013

Rank	Top 5 risers	Share price (local currency)			Market capitalisation (\$m)	
		H1 2013	YE 2013	Change	H1 2013	YE 2013
1	Mako Surgical	\$12.05	\$29.99	149%	565.66	1,544.66
2	Given Imaging	\$14.01	\$30.08	115%	439.52	957.83
3	Affymetrix	\$4.44	\$8.57	93%	315.68	616.33
4	Natus Medical	\$13.65	\$22.50	65%	414.78	696.69
5	Cardiovascular Systems	\$21.20	\$34.29	62%	509.69	954.26
Top 5 fallers						
1	Sequenom	\$4.21	\$2.34	(44%)	484.79	270.78
2	Merge Healthcare	\$3.60	\$2.32	(36%)	336.48	218.29
3	Precision System Science	¥1,294	¥883	(32%)	241.57	153.47
4	NxStage Medical	\$14.28	\$10.00	(30%)	853.04	609.31
5	Aerocrine	SKr10.10	SKr7.35	(27%)	240.66	177.32

Given Imaging, developer of the PillCam line of gastrointestinal imaging devices, was bought by Covidien in a deal announced last month – one of the largest in medtech this year, at \$860m ([Covidien's purchase of Given Imaging is third biggest deal announced this year, December 9, 2013](#)).

The Given story illustrates not only the uptick in M&A in the second quarter, but also the increasing boldness of medtech shareholders, more willing than ever to make demands of management. In Given's case the

investment fund Discovery Group insisted that the firm pursue a \$50m share buyback and a subsequent buyout; Given duly complied. The success of this and similar plays means that investor activism could come to be as normal in medtech as it is in biotech.

Meanwhile, Sequenom suffered its worst drop on the release of its second-quarter results in July. Diagnostics revenues were down 9% and the firm's net loss widened 6% quarter on quarter after changes to Medicare reimbursement delayed payments.

But later in the year the company's shares fell once more as it became the second group to suffer after a court determined that a natural phenomenon is not patent-eligible. As with Myriad Genetics - whose Supreme Court case was specifically cited as a precedent - the patent on Sequenom's diagnostic technology covers a specific sequence of unaltered human DNA, rather than the technology used to detect it ([Sequenom becomes second casualty of Myriad ruling](#), November 4, 2013). This is fast becoming an untenable strategy.

Swap

The leader of the micro-caps, New Zealand's Pacific Edge, saw its biggest share price jump in October on the first commercial sales of its bladder cancer test, Cxbladder, in the US. The intersection between the ever-popular diagnostics and oncology areas has again proved fruitful.

It is reassuring to see Optos in the risers as it rides out the difficulties it made for itself in booking revenues from leases of its retinal imaging equipment up front rather than gradually ([Optos blindsides investors with big profit drop](#), May 16, 2013). The company was the second-largest faller in the micro caps in the first half of this year, so this is a pleasing turnaround.

Micro cap (\$100-250m) medtech companies: top risers and fallers in H2 2013

		Share price (local currency)			Market capitalisation (\$m)	
Rank	Top 5 risers	H1 2013	YE 2013	Change	H1 2013	YE 2013
1	Pacific Edge	NZ\$0.59	NZ\$1.33	125%	139.42	353.14
2	Anika Therapeutics	\$17.00	\$38.16	124%	237.93	527.60
3	AtriCure	\$9.50	\$18.68	97%	198.85	392.63
4	CryoLife	\$6.26	\$11.09	77%	171.96	306.21
5	Optos	115p	202p	76%	126.51	234.88
Rank Top 5 fallers						
1	Baxano Surgical	\$2.40	\$1.01	(58%)	108.41	45.65
2	LipoScience	\$6.99	\$4.25	(39%)	102.58	64.44
3	Bioneer	KRW16,700	KRW11,000	(34%)	186.75	134.15
4	Hutchinson Technology	\$4.73	\$3.20	(32%)	129.09	89.74
5	Nanosphere	\$3.07	\$2.29	(25%)	177.86	173.09

A less pleasing turnaround is that performed by Hutchinson Technology: in the micro cap risers in the first half and now among the fallers. In July, the oxygen perfusion monitor manufacturer posted fiscal 2013 third-quarter pretax profits of \$1.4m, or 2% of net sales, compared with \$8m, or 13.1% of net sales, in the second quarter, causing a 29% drop in its share price.

Smaller cap companies are always more prone to share price fluctuation than their larger cousins, particularly in the medtech sector, itself fairly staid in comparison with the more flamboyant biotech arena. But companies must work to avoid ricocheting from one extreme to the other as Optos and Hutchinson have done.

To contact the writer of this story email Elizabeth Cairns in London at elizabethc@epvantage.com or follow [@LizEPVantage](https://twitter.com/LizEPVantage) on Twitter

Evaluate HQ
44-(0)20-7377-0800

Evaluate Americas
+1-617-573-9450

Evaluate APAC
+81-(0)80-1164-4754

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