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Cardinal-Cordis deal highlights genericisation of medtech

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Two $1bn-plus deals in a single day, and three in a week – looks like medtech M&A madness is back on. The announcement of the Boston-AMS deal yesterday preceded news of Cardinal Health's purchase of Johnson & Johnson's Cordis unit by less than an hour.

Cordis pioneered drug-eluting stent technology and was once a major force in the cardiovascular device market. In recent years it has stagnated, with its device sales barely ticking over and little sign of R&D activity. Cardinal Health gains most of its revenues from the distribution of generic drugs; it appears that it also sees a future for what are essentially generic devices.

Cardinal's bid is worth $2bn, $1bn of which will come from new senior unsecured notes and the rest from existing cash. J&J had acquired Cordis in 1996 for $1.8bn in cash – $2.7bn in today's money.

Fast and slow

While some sectors of the device market are moving fast – sequencing-based diagnostics being an obvious example – others are moribund, because the market is sufficiently well served by old devices and the disruptive new technologies that could improve sharply on the current offering are too expensive or still unproven.

Orthopaedics is one such area. Put bluntly, there is only so much that can be done to improve an artificial hip, and no one hip implant is meaningfully differentiated from its fellows. Hip implants are, to all intents and purposes, generic.

Cordis sells interventional catheters, balloons and guidewires, plus stents for use in the bile ducts and peripheral vasculature (as opposed to the drug-eluting coronary stents that made its name). As with hip implants, there is little differentiation among these kinds of devices. It exited drug-eluting stents in 2011 after Cypher, its trailblazer, was superseded by later-generation devices from other companies (*J&J's rumoured Cordis sale would go against the flow, August 29, 2014*).

Buying this unit is consistent with Cardinal's strategy of acquiring companies with hospital sales platforms in the areas of cardiology, orthopaedics and wound care. It purchased AccessClosure, the maker of femoral artery sealant devices, last year for $320m.

Price war?

Cardinal Health expects synergies of more than $100m by the end of fiscal 2018. Writing in February, Morgan Stanley analyst Ricky Goldwasser said Cardinal would require a smaller direct sales force than the typical cardiovascular devices model, with a single rep able to call on interventional cardiologists and vascular surgeons.

This might permit Cardinal to cut the prices of its products, Morgan Stanley's David Lewis wrote in February. If Cardinal does decide to compete on price with Cordis products there could be an incremental negative for Boston Scientific given its strong competitive positions in guidewires and catheters and its leading position in balloons.

Abbott's leading franchise in guidewires would also face some competitive risks, Mr Lewis wrote, and Medtronic would also be affected, though less so.

Cardinal virtue

J&J does not give specific sales figures for Cordis, instead reporting revenues for its cardiovascular care business which combines Cordis with its electrophysiology unit Biosense Webster. *EvaluateMedTech*'s consensus of analyst estimates, however, puts Cordis's 2014 sales at $955m. These are forecast to fall to $806m in 2020, perhaps explaining why Cardinal got the company at such a low sales multiple.

The conglomerate is far from opting out of medtech entirely, despite hiving off its Ortho-Clinical Diagnostics unit to private equity for $4.2bn last year. As well as Biosense Webster J&J still has its DePuy/Synthes orthopaedics arm as well as surgical and diabetes devices and contact lenses. Minus Cordis and Ortho-Clinical, J&J's medtech revenues will top $25bn in 2015, according to *EvaluateMedTech*, compared with sales of around $72bn from its pharmaceutical and consumer health segments combined.

Until pressure on pricing slackens – if it ever does – no hospital or payer is going to fork out for an innovative product when the cheap old ones work well enough. If Cardinal Health can make a success of low-price, high-volume devices, this type of deal ought to become more common in future.

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