Evaluate Vantage

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$2bn buy moves Hill-Rom away from the hospital

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Hill-Rom was founded in the days following the Wall Street crash of 1929 to provide wooden furniture to US hospitals. In the years since it has diversified but still remained largely focused on hospital equipment.

It has now taken a definitive step away from this low-margin business into point-of-care diagnostic technologies and monitoring devices more commonly used in doctors' offices with its $2.05bn cash-and-stock purchase of Welch Allyn. Hill-Rom has been expected to make an acquisition for some time, and the choice of Welch Allyn appears to have pleased its investors: Hill-Rom's shares rose 6% yesterday to $55.70.

Much of Hill-Rom's current business centres on hospital infrastructure – beds, lighting and devices to lift immobile patients, for example – though it also sells medical devices such as nebulisers. Cost-conscious hospital chains, still unwilling to shell out for new equipment even though the recession is now past, often decide they can make these products last a few more years rather than replacing them.

Diversifying into other, more innovative, devices for which there is a constant demand and whose purchase cannot be put off is an obvious way for Hill-Rom to limit its exposure to hospitals' make-do attitude. In recent months it had been suggested that Hill-Rom could pick up business units that larger companies were being forced to divest during last year's rash of megamergers, with respiratory assets from Medtronic or Becton Dickinson being mooted as possible targets.

Welch Allyn does indeed have respiratory technologies, and being centred on patient monitoring rather than delivering therapy could mean they mesh well with Hill-Rom's existing product lines, which are used to treat disorders including cystic fibrosis, COPD and chest trauma.

The private Skaneateles Falls, New York, group also makes diagnostic equipment such as electrocardiographs, blood pressure monitors and ophthalmoscopes. These are medical devices as opposed to hospital equipment, but not so far from Hill-Rom's historical strengths as to be unfamiliar.

Biggest yet

The owners of Welch Allyn are to get $1.63bn in cash and 8.1 million new Hill-Rom shares; they will own around 13% of the merged company. Hill-Rom is paying 13-14x EBITDA for the company but believes it can wring annual rate cost savings of at least $40m by 2018, through changes to facilities, procurement and cuts to general and administrative expenses.

According to analysts at Bank of America Merrill Lynch, the deal will reduce Hill-Rom's exposure to capital equipment budgetary limits from roughly 50% to 30% while increasing margins. They say there is potential for 15% accretion in 2016 and 25% in 2017, above the company's guidance of 10% and 15-20%, respectively.

In a low-key year for medtech M&A this is the most expensive deal yet, knocking Cardinal Health's purchase of Johnson & Johnson's Cordis unit for $1.94bn in March off the top spot. It is possible that mergers will pick up again – Abbott Laboratories, for instance, has stated that it intends to build scale inorganically – but for now Hill-Rom is in the lead. If the choice of Welch Allyn turns out to be as wise as its investors believe, it will be money well spent.

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