Evaluate Vantage

July 07, 2015

Big-cap medtech shares fall as atmosphere cools

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With mergers cooling down in medtech, it looks like the markets are too. For the first time in two years, large-cap medtech companies – four of them – have seen their share prices slide.

There are a variety of reasons, from missed profit targets to disappointed expectations of a takeout, and macroeconomic factors including the Eurozone crisis have played their part. There is some cheer among the risers: the gains are driven by approvals and successful launches of promising technologies, as well as smart deal-making.

It appears that the US medtech stock indices have caught whatever disorder has been afflicting Europe in the second half of 2014. All are in the mid-single figures – a small improvement for the European index but a huge downward lurch for those in the US (*Mergers fuel big-cap medtech stocks in 2014, January 13, 2015*).

Stock Index	**% change in 2015**
Thomson Reuters Europe Healthcare (EU)	4%
Dow Jones U.S. Medical Equipment Index	5%
S&P Composite 1500 HealthCare Equipment & Supplies (US)	5%

It is perhaps reassuring to see the gain by the top riser – this time, Boston Scientific – back in the low 30% range. The top riser has increased by between 32% and 34% every time *EP Vantage* has done this analysis, except the last. The anomalous showing by Covidien last time around – a jump of 53% in its shares – was yet another one-off effect of its purchase by Medtronic, the ripples of which are only now starting to dissipate (*Medtech on course for $100bn in mergers by year-end, July 6, 2015*).

Boston's 34% rise to $17.70 comes with approval and launch of several new products, most notably the left atrial appendage device Watchman after a number of missteps. The forthcoming US launch of the Synergy stent, which has a biodegradable polymer designed to minimise thrombosis, is also building sentiment.

The biggest jump, however, came with the settlement of a lawsuit with Johnson & Johnson dating from 2004 when the two groups were locked in a battle to acquire pacemaker maker Guidant. Boston managed to settle the case for just $600m – not bad considering that J&J had sought up to $7bn in damages.

Another gainer on a product approval was Edwards Lifesciences, which saw a late bump in its stock when its newest heart valve, Sapien 3, was granted premarket approval by the FDA in June (*Edwards tightens transcatheter valve stranglehold, June 18, 2015*).

The approval had been expected in the second half of 2015, so the news that the dominant player in transcatheter valves had reinforced its control of the market, and done it early to boot, was welcomed by investors.

Large cap ($15bn+) medtech companies: top risers and worst performer in H1 2015					
	Share price (local currency)			Market capitalisation ($bn)	
Top five risers	**YE 2014**	**H1 2015**	**Change**	**H1 2015**	**6M change**
Boston Scientific	$13.25	$17.70	34%	23.7	6,154
Essilor International	€92.68	€107.00	15%	25.0	517
St. Jude Medical	$65.03	$73.07	12%	20.5	1,876
Edwards Lifesciences	$127.38	$142.43	12%	15.3	1,693
Abbott Laboratories	$45.02	$49.08	9%	73.1	5,277
Top Fallers					
Intuitive Surgical	$528.94	$484.50	-8%	17.9	-1,317
Smith & Nephew	$36.74	$33.95	-8%	15.2	-1,681
Baxter International	$73.29	$69.93	-5%	38.0	-1,712
Zimmer	$113.42	$109.23	-4%	22.2	2,977

The leader of the fallers, Intuitive Surgical, saw its shares rise 38% over the course of 2014 thanks in part to excitement around the launch of its next-generation surgical robot, the da Vinci Xi. In the past six months, however, the mood has changed.

Intuitive's sales figures for Q1 showed that it missed the consensus revenue forecast, albeit not by much – but it missed consensus earnings expectations by a much larger margin. Goldman Sachs analysts said that at $3.57, adjusted EPS for the quarter fell well short of the consensus estimate of $3.87.

Microcosm

Perhaps it is Smith & Nephew, though, that is most emblematic of the trends in the medtech sector. The company had been thought of as a takeover target even before the tidal wave of consolidation swept through the industry last year. Moreover its UK base made it highly attractive for tax reasons; since the M&A trend took off in spring 2014 a buyout was taken as almost inevitable.

And with the Zimmer-Biomet tie-up apparently showing that the FTC had no objection to very similar ortho companies merging, Stryker was taken to be the likeliest buyer.

Picture investors' shock, then, when in early March Stryker announced a $2bn share buyback. This utterly precluded a bid for Smith & Nephew, whose shares spiralled 5% on the day and have sunk even lower since.

Arguably this shows the medtech industry in the first half of 2015 in microcosm. Mergers are going out of fashion and the chances of a quick buck for shareholders are shrinking as a consequence.

Perhaps the industry needs a reality check after the soaring performance of the last two years. The question is whether this is a temporary lull or the emergence of a more relaxed medtech sector.

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