Evaluate Vantage

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Sun comes out for big-cap medtechs as investors seek refuge from market squalls

Elizabeth Cairns

The recovery of large-cap medtech companies is well under way – at least in the US. Six months ago five companies with market caps above $15bn had seen their stock fall over the preceding year, but at the end of June shares in only three large-cap companies had declined.

This is still not a recovery to the 2013-14 era of across-the-board rises, but it is a definite improvement. Perhaps investors are sinking their cash into medtech as a low-risk play in volatile times; this would appear to be borne out by the lacklustre share performance among larger drug makers (*2016 share gainers signal flight to safety, July 5, 2016*).

It seems that companies listed on US exchanges are doing better than others, perhaps partly because European stocks were hobbled in late June amid turmoil caused by the UK's vote to leave the EU. US indices of medtech stocks were up by around 11%, whereas Thompson Reuters' index of European healthcare stocks sank 5%.

Stock index	% change in 2015
Thomson Reuters Europe Healthcare (EU)	-5%
Dow Jones U.S. Medical Equipment Index	11%
S&P Composite 1500 HealthCare Equipment & Supplies	12%

The below analysis considers companies with a market cap above $15bn, and which obtain more than 40% of their revenues from sales of medical devices.

Top of the heap with a 29% share price jump is deal-maker Stryker, which has impressed with two $1bn-plus acquisitions and several smaller deals so far this year (*Stryker's Synergetics deal is smaller but no less sage, February 11, 2016*).

Organic growth and innovation

Boston Scientific's stock leapt 11% in late April when the company announced better than expected first-quarter financials. In sharp contrast to Stryker, the company's 8% sales growth was entirely organic, suggesting that its products are gaining market share.

Boston has taken the top spot throughout 2015, with shares up 34% during the six months to last June and 39% across 2015. A rise of 27% over the past half year is less steep; still, management is unlikely to be worried just yet.

St. Jude Medical, in third place amid the risers, is not predator but prey. When Abbott Laboratories said it was taking its cardio competitor out in late April for $25bn – by far the biggest medtech merger so far this year – St. Jude's shares got a 26% bump to get close to the approximately $85-per-share price.

Edwards Lifesciences is probably alone amid the big-cap cohort in that a single study of one of its devices can move its shares – and move them significantly. Its stock surged 18% on April 4 when data on its Sapien XT transcatheter aortic valve showed it to be as effective as surgery but far less invasive – and, of course, cheaper – and suitable for use in a very broad population.

Amid companies growing thanks to scale-building megamergers in increasingly commoditised sectors it is pleasing to see innovation rewarded. Edwards, with its extremely tight focus on the wildly successful transcatheter valve area, has long looked like a takeout target, and even though its market value has soared over the past few years it might still not be a surprise to see a bid from the likes of Medtronic.

Downs

Abbott is at the head of the share price fallers, with its biggest single-day drop, of 8%, coming the day the St. Jude deal was announced. But it has another deal on the table, and this one is trouble.

In February Abbott agreed to by the diagnostics specialist Alere for nearly $6bn – a sizeable premium to the company's share price despite it having $2.6bn of debt. But, if the deal looked poor at first, it got worse soon after, with Alere facing a US Department of Justice investigation into alleged corrupt sales practices and missing its filing deadline for its 2015 annual report.

Abbott has already tried to cancel the acquisition and there is a definite question mark over whether this will in fact close (*Debt, integration and buyer's remorse: can Abbott pull off its deals?, May 6, 2016*).

The Danish group Coloplast is, like Stryker, active in an unglamorous and commoditised space. Unlike Stryker, the ostomy and continence device maker has not conducted an acquisition since 2010, and has posted a succession of missed EBIT and profit targets.

Large cap ($15bn+) medtech companies: top risers and fallers in H1 2016				
		Market capitalisation ($bn)		
Top 5 risers	**Share price change**	**YE 2015**	**H1 2016**	**6M change**
Stryker ($)	29%	34.95	44.81	10.15
Boston Scientific ($)	27%	24.81	31.71	6.88
St. Jude Medical ($)	26%	17.46	22.17	4.67
Edwards Lifesciences ($)	26%	17.04	21.12	4.11
C. R. Bard ($)	24%	14.00	17.24	3.28
Top fallers				
Abbott Laboratories ($)	(14%)	66.99	57.75	(9.24)
Coloplast (DKr)	(13%)	17.32	15.02	(2.30)
Smith & Nephew ($)	(4%)	15.95	15.35	(0.61)

Abbott's fall, of course, came as a result of the better of its two large deals. The St. Jude buy will make Abbott one of the most important players in cardiology, adding cardiac rhythm management devices to its already impressive interventional capabilities. But that will take time, and shareholders seem focused on the short-term.

Still, overall 2016 has not been bad so far for the largest medtech groups. As the markets are likely to continue to be rocky for some time these companies could continue to profit from looking like a safer place to invest than biopharma.

To contact the writer of this story email Elizabeth Cairns in London at elizabethc@epvantage.com or follow @LizEPVantage on Twitter