

Shopping for Value

Despite current economic woes, foreign buyers see good opportunities for acquiring U.S. medtech companies.

James R. Brennan

Recent visitors to New York's Fifth Avenue or San Francisco's Union Square have noticed the large number of foreign tourists shopping, snapping up bargains in (to them) cheap U.S. dollars. Economists attribute the crowds of eager tourists to a combination of the strength of foreign currencies versus the dollar, and a reduction in domestic buyers due to the poor U.S. economy.

Much the same is happening in the healthcare technology marketplace: foreign investors are finding many attractive values in U.S. companies.

According to deals tracked by VirtualCDO (Great River, NY), 75 healthcare M&A deals were announced in July 2008.¹ Of these, 25 (33%) were executed by foreign buyers. Of the top 10 deals recorded so far in 2008, most were foreign acquisitions of U.S. companies, including the following.



Brennan: Medtech bargain hunting.

- Fresenius SE (Bad Homburg, Germany) bought APP Pharmaceuticals (Schaumburg, IL) for approximately \$4 billion.
- Getinge AB (Stockholm, Sweden) acquired Datascope (Montvale, NJ), a vascular surgery device manufacturer, for some \$900 million.
- Stanley Canada Corp. (Oakville, ON) acquired Xmark Corp. (Ottawa) from VeriChip (Delray Beach, FL) for \$47.9 million in cash.
- Roche Holding Ltd. (Basel, Switzerland) offered to acquire the 44% it did not already own of Genentech (South San Francisco, CA), making an \$89 per share cash offer totaling about \$43.7 billion.
- Kowa Co., Ltd. (Nagoya, Japan) acquired ProEthic Pharmaceuticals Inc. (Montgomery, AL), for an undisclosed sum.
- GE Healthcare (Chalfont St. Giles, UK) is acquiring Vital Signs Inc. (Totowa, NJ) for approximately \$860 million.

There are three reasons for the burgeoning foreign interest in U.S. healthcare technology companies. First, a very favorable exchange rate (i.e., a cheap U.S. dollar) has made acquisition of U.S. companies less costly for foreign buyers. Second, the cheap dollar has made it very expensive for U.S. companies to buy foreign companies. Historically, U.S. companies have been buyers of—not sellers to—foreign companies. Finally, many foreign buyers are bullish that the U.S. recession will be short lived, and they are betting they can buy now at a bargain and ride the valuation to higher—that is, nearer-to-normal—levels.

Foreign buyers of healthcare technology companies are looking for investments of lasting value. They acquire companies in desirable markets with excellent future prospects. After all, the exchange rate differential plays two ways. While foreign companies are getting more for their investment dollar, they are getting less excess cash flow back to their foreign bank accounts.

Trends for 2009

The recent credit crisis will undoubtedly have an impact on healthcare technology investment in 2009. While it is difficult to predict the bottom of the economic downturn, some broad trends have become visible.

First, venture capital spending will decrease from the historically high levels of recent years. Venture capital investments hit a record \$9.9 billion in 2007, according to a recent Dow Jones Venture Capital Report.² The report found new investments dropped by 31% in the first half of 2008 compared with a year earlier. In the medical device category, investments dropped 25% in the second quarter of 2008, compared to the previous year.

Although venture capital investments are down, overall spending on healthcare will rise in 2009. A recent report by the Government Accountability Office (GAO) found that healthcare spending in the U.S. reached \$2.3 trillion in 2007.³ The report forecasts that this amount will top \$4 trillion by 2016, which would be some 20% of total GDP.

Put into historical context, the GAO projection for 2016 translates into per-capita healthcare spending of some \$12,800 versus \$7498 in 2006 (or an increase of 70%). Of this, public spending will represent 49% of the total in 2016 versus 40% in 1990 and 38% in 1970.

In the healthcare information technology sector alone, federal spending will increase substantially—to \$4.5 billion—by 2013, according to *Government Healthcare IT* magazine.⁴

A number of new government mandates will drive both federal- and private-sector spending. For example, a new federal e-prescribing incentive program is set to begin on January 1, 2009. Under this new program, physicians who adopt e-prescribing technology during 2009 and 2010 will receive a 2% bonus in their Medicare payments.

The regulators at the [Centers for Medicare and Medicaid Services](#) have told U.S. hospitals that starting October 1, they won't be reimbursed for so-called 'never events'—problems or diseases that patients should never acquire during a hospital stay. The dozen treatment areas on the list are considered 'reasonably preventable' and aren't present when a patient checks in.

Although complying with this rule will require new investments in medical technology, the rule is ultimately designed to save the government money. Federal regulators estimate that some \$21 million would be saved annually by not paying for 500,000 follow-up procedures to correct complications acquired in hospital hallways. Even so, that's a virtual rounding error when compared with the \$110 billion that the Medicare program pays to hospitals each year.

In addition, other new mandates are being actively discussed. These include adoption of new ICD-10 coding requirements and new claims attachments standards. Implementing these changes will compel replacement of many existing hospital information systems. Some experts believe this will take money away from investments in clinical IT programs over the next two to three years. After all, coding and claims attachments directly affect a hospital's bottom line.

Avoiding Broad Market Affects

The recent banking industry meltdown aside, it is interesting to note that during July and August 2008—a time when the S&P 500 index lost 2.4%—the Standard and Poor's healthcare equipment index gained 7%. However, the market collapse in October caused severe declines in the medical device sector and many broader indices, including the Nasdaq and S&P 500.⁵

One reason for the relatively positive overall performance of the sector, say investment analysts, is that the medical device industry, along with biotech, is benefiting from a rotation out of consumer and high-tech stocks and attracting money that might otherwise have flowed to pharmaceutical or managed care stocks.

Drug stocks have suffered as companies have struggled to replenish pipelines and get new products approved, while the health insurance industry is wrestling with rising costs. If market uncertainty continues, medtech valuations are likely to rise. After all, while earnings in the manufacturing and financial sector appear to be very sensitive to trends in the broader economy, companies in the medtech sector are more predictable, a fact that should lead to higher multiples.

According to the Bureau of Labor Statistics, hospitals hired roughly 3500 workers during September—a 0.1% increase—bringing total hospital employment to 4.67 million workers.⁶ For the 12 months ended in September 2008, hospital payrolls increased by about 129,300, or 2.8%. By contrast, the other sectors of the U.S. economy have lost 760,000 jobs in the first nine months of 2008.

Conclusion

The United States has some 5000 hospitals, half a million practicing physicians, and a graying population that is willing to spend money on itself to maintain its health. Barring any additional unforeseen economic calamity or a huge increase in the value of the dollar, the U.S. healthcare marketplace will remain attractive for foreign investors throughout the coming year.

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