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# Positive Medtech Revenues Into H2, But M&A And IPOs May Wait

*Medtechs Count On Path To Greater Stability And Revenue Growth in H2 2022*

by **Ashley Yeo**

EY's John Babitt provided a mid-year 2022 update on medtech investment trends, and the outlook for the industry going into 2023 in this commentary for *In Vivo*.

**Q** *In Vivo*: As we move into the second half of 2022, do you observe that the post-COVID recovery in medtech is still going apace?

**A** John Babitt: Looking at the Q2 readouts, the results have been a little choppy. There is not one consistent narrative across the industry. There are companies that have announced a fuller recovery, but also a few remaining 'air pockets' partly as a result of continued lockdowns in China or ongoing hospital staffing shortages. There has been a real bumpiness to the recovery, and the rising tide has not lifted all boats. Constraints in the supply chain simply add to that mix.

In Q2, we also detected some noise around capital equipment, given that hospitals do not feel as flush with cash as they were during COVID, for various reasons. We started to see a little softness in the capex side of the business, especially in the heavy iron. Small capital may be more insulated than large capital, as it tends to be more closely tied to volumes and driving efficiency. We're also hearing and seeing more placements of leases/rentals as opposed to sales.



*John Babitt*

incremental trepidation.

We still see good receptivity on the private equity capital markets, and funding has continued to be pretty robust. The recent \$192m round in the cardiovascular space [Clearly, artificial intelligence-powered imaging to analyze heart scans] bears this out.

The debt markets have been fairly active as well, especially on the private side. For companies that do want to do deals, I would say we are seeing a stabilization of some of the credit markets. We saw a couple of deals get refinanced at unfavorable rates, but a large part of what we've been seeing and hearing is that there is pretty good availability on the credit side in the private markets as well.

## **Q Did The Unprecedented Performance Of 2021 Set The Benchmark Too High?**

**A** The first quarter of 2022 was the story of Omicron, and the second quarter was a tale of continued uneven results. But I think more than 50% of companies have found their way through, and this could be a real positive for the industry with the hope it

continues as a trend as we go further into H2. Medtechs could be seeing a path to greater stability and impressive, sustainable revenue growth.

Looking back at the numbers, coming off 2020, 2021 was a really good year for medtech revenue growth, and we saw double digits across the industry. We'll get a fuller picture of the H2 results when we launch our Pulse of the Industry 2022 report [in October], but we're probably looking now at high-single digits revenue increases, so overall there is generally a positive momentum.

It's interesting to see the increase in public companies, the number of which has grown pretty dramatically in the past couple of years. The reasons are two-fold: we've seen a lot of spins – [\*Becton, Dickinson and Company\*](#) (Embecka); [\*Zimmer Biomet Holdings, Inc.\*](#) (ZimVie); Colfax (Enovis) all had spins—and we will see more spins at [\*Johnson & Johnson Consumer Inc.\*](#), [\*GE Healthcare\*](#), Labcorp's Clinical Development business and [\*3M Healthcare\*](#); and in terms of IPOs, we've seen a pretty big second half of 2020 going into 2021. In 2021, we posted a record number of IPOs in medtech. We haven't seen that level of activity for quite some time.

In 2022, it is not quite a desert for medtech IPOs—but there's certainly not a lot of water! We're not expecting to see real robustness of medtech IPOs coming into the second half of 2022. Without the IPO market, most of the companies we talk to are thinking about raising more private capital. And thereafter proving out their business for another six months, getting a good growth trajectory that they can tell a story around, and looking towards 2023 for public offerings.

Lastly, given the muted performance of SPACs, investors behind SPACs are losing or have lost confidence. Right now, that is not an attractive pathway for late-stage companies looking to raise capital.

**Q** What are you seeing in terms of shareholder confidence in the public medtech markets?

**A** We haven't seen any big decline. We haven't crunched all the numbers yet, but when

we do look at them, we feel the decline in medtech will be less than the decline in the broader markets. There are some good reasons for durability in the medtech sector going forward.

**Q How are medtech company valuations performing?**

**A** In the public markets, most companies have taken a hit in 2022, but the private markets have held up. There are fewer exits occurring in 2022, so far. People are hoping that valuations drift positive, and that more opportunities arise in the back half of 2022.

**Q And seed and series A investments in particular?**

**A** Looking at H1 2022, even at the seed round, there was pretty good access to capital. Part of that is due to the increasing significance of private equity, and where it has grown to; more of the larger institutions are raising larger funds, some of the funds are looking to allocate capital at earlier stages. Medtech as an ecosystem has benefited from some of those broader trends and the development of the overall PE market.

**Q Medtech M&A has undergone a dip of late?**

**A** M&A was really active in back half of 2020 and all through 2021. Maybe there's an argument that we had a little more activity then than we would normally have seen. Now the activity has fallen off, people are trying to gain more confidence in their underlying business. But I still think we'll see more activity on the medtech M&A front, towards Q4 and into 2023.

**Q The medtech SPACs environment is muted, but they are not yet dead and buried?**

**A** SPACs have got to be used up in 2022 and 2023. We did have the SPAC deal announced in July 2022 from [Orchestra BioMed, Inc.](#), with [Medtronic plc](#) as an investor. We have to see about the pricing, but they were pretty confident. There's

certainly not the interest there was in 2021, but one-offs are still getting done.

**Q What are the sustained hot medtech investment sectors?**

**A** I'd say we're seeing increased interest in robotics and digital surgery, liquid biopsy and non-imaging diagnostics, as well as any technologies that can facilitate care outside of chronic or acute care hospital settings. We're seeing a lot of interest in remote monitoring: a couple of firms announced large rounds in the first half of 2022. These are the areas where I'd expect to see continued investments.

**Q How are macro environment factors influencing investment decisions?**

**A** We're seeing some credit and equity PEs offer discount rates on favorable terms if companies are willing to incorporate ESG programs. Within medtech, there are also the elements of employee dynamics, and focus on diversity and inclusion, as well as things like access to health care and the benefits to society of medtech innovation. So the unique position medtech is in has seen it take a slightly different twist.

In supply chain, there is still a shortage of microchips for the industry. The situation is supposedly improving according to Q2 conference calls, but chip shortages remain a prevalent issue. Medtech executives made their feelings known during recent debates around the passage of the CHIPS [Creating Helpful Incentives to Produce Semiconductors] and Science Act of 2022 in the US. [President Biden on 9 August signed the landmark bill, which will provide \$52.7bn in subsidies for onshoring US semiconductor production and research.]

**Q Rising inflation is now clearly on the radar of the medtech industry?**

**A** For medtech, it is having impacts up and down the P&L. Certainly, you are seeing it with raw materials, such as cobalt, chrome and titanium components used in orthopedics, and pacemakers (lithium batteries), having increased in price dramatically. There's a lot of labor that goes into the manufacturing process, and the cost of labor has increased, as disclosed in earnings statements, and that has a real impact as well.

Inputs like electricity, especially relating to manufactured goods coming out of Europe, where the inputs have been dramatically impacted, are increasing. The costs of getting products to the hospital have also increased in the past year. For example, we've seen data showing that freight inflation is up over 60% over last year. These higher shipping costs generally disproportionately impact capital equipment over consumables, as well as companies that directly ship products to and from the end patient.

Medtech has not been immune, and we're seeing the impacts as companies file their second quarter results.

**Q How acute are the potential geopolitical effects on medtech markets?**

**A** Regarding Ukraine, we haven't noticed the conflict having a dramatic effect on the industry. Large-cap medtechs are minimally exposed to the impact of Russia's invasion of Ukraine, including international sanctions, as Russia/Ukraine make up 1% or less of revenues for the group.

But things like airspace restrictions with the additional transport costs entailed are a factor, as the industry has a responsibility under international humanitarian law to continue supplying products in Russia and Ukraine.

In addition, a lot of the big companies are considering evaluating how they allocate capital to China. Value-based procurement currently being rolled out in China has had a big impact. Companies are examining how they can become local manufacturers in China. They want to know how to compete effectively when revenues are going up, but margins are going down.

Companies are having to address long-term strategies, but there are still more questions than answers right now. They are wondering how to put investment capital to work. I think we're probably experiencing a wait-and-see attitude until companies have the clarity on which to base long-term decisions.

**Q** So there is certainly no investment cliff-edge after the superlative 2021?

**A** Private equity is likely to be sustained. Talking to PE investors, it's clear that medtech is an area they like, including at the non-end-product level. For instance, they like CMOs, lab equipment and diagnostics. There is a good level of activity in this space.

The private market remains active, and investments are being made now for down-the-road exits, whether IPOs or M&As. Right now, companies are putting many of their execution wins on the board, putting their capital to work and focusing on core business.

Medtech is a space fueled by innovation. R&D from a US dollar perspective is up year-on-year. I get the impression when we talk to medtech executives that they feel the worst is behind them. Many of them feel positive about the rest of the year, and certainly the future ahead.

*John Babitt is a life sciences partner at EY, with 30 years of experience in the life sciences and health care industries. He advises strategic and private equity life science clients, and has a particular focus on medical technology.*