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The consensus among investors is that medtech has been the best-performing part of health care for the past three to four years, and investment levels remain good. Seemingly all-encompassing of late has been companies' preoccupation with digital strategies, but there is a lot more to this unique industry than just digital.

BY ASHLEY YEO

For investors, medtech may be behind biotech and pharma in terms of the weight of money invested, but combined with digital – now said to be truly coming of age – people are beginning to pay serious attention to medtech.

But there is also a lot more to medtech than just digital capabilities: how to bring devices to market in a complex health care landscape remains the province of the industry, which is acknowledged by the tech companies.

M&A deals remain notable in number – if smaller than in recent years – and the IPOs that are happening are mainly right-priced and are followed by a price uplift. This is contributing to the health of the innovative medtech sector, a stable and reliable industry for investors.

Pick your way through the complications and challenges faced by health care industries, and, as we move into the 2020s, investors will find medtech in a good place. Make that *continue* to find, because, many health care investors view medtech as the stand-out life sciences performer in the recent past.

This is seen in many aspects of performance, and not just in the pace of revenue growth. Levels of innovation, quality of management teams and capital deployment efficiencies, among others, have been appreciated and recognized in this sector.

It is a more predictable industry too, in the view of David Mardle, a partner in Goodwin's Technology and Life Sciences group. Mardle leads the law firm's newly opened Cambridge, UK office, where a team of life sciences and technology lawyers work on cross-border M&A, venture capital, intellectual property, licensing and regulations.

Medtech's relative stability is valued by investors and pension funds alike. The sector is in some ways seen as a safe haven – not as risky as biotech and pharma discovery, but offering more growth upside than other sectors, Mardle said in comments to *In Vivo*.

The composition of the top 25 global medtech companies has barely changed in the past year or two – in the most recent annual Medtech 100 ranking, the only change was the post-acquisition exit of St. Jude Medical Inc. But it is not a static industry: the big medtech M&A deals might have become rarer in 2019, but across the board deals have not significantly slowed (even if deal sizes have). Johnson & Johnson, with its milestone-enhanced $5.8bn purchase of surgical robotics company Auris Health Inc. a year ago; 3M Co., with two major deals in 2019; Stryker Corp. (regularly a key M&A player); and Boston Scientific Corp. (with 12 deals in the past 24 months), notably have continued to fly the M&A flag in recent times.

Yet there are always new companies joining the industry and ready to address needs – societal as well as corporate. After shelter and food, health/health care are next on the list of priorities for the aspiring "middle class" globally, and medtech fits right in, addressing the needs of an aging population and unmet clinical needs with healthtech engineering.

The preoccupying theme at present for medtech corporates, the media, clinicians and caregivers alike, is the integration of digital solutions and strategies to cope with increased demand, more quickly, with fewer staff and at improved levels of quality. The digital revolution, the Internet of Medical Things (IoMT) and the power of artificial intelligence (AI) are transforming the industry. And where this is not quite happening in practice, it is transforming the way people perceive the medtech industry.

Digital Health Care Is "Finally Coming Of Age"

Add digital to medtech, and it becomes a life sciences investment proposition to rival biopharma for its size and potential, said Sophie McGrath, a fellow partner of Mardle's at Goodwin. McGrath's view is that "digital health care is finally coming of age." Medtech by itself still trails biotech and pharma, in the context of weight of money invested, but with digital, people are now paying serious attention to medtech, whereas it used to be fringe, and few knew how or even if it was regulated.

But there is now a constant sense that, with digital, health care is on the cusp of something transformative. The pool of investors in digital is broader, and tech investors in digital health are less risk averse on the technology. On the other hand, they are prone to underestimating the complexity of the health care regulatory landscape and how to sell into different jurisdictions.

However, it has not been all a digital show, said Jefferies Healthcare analyst Raj Denhoy at the investment house's 2019 conference in London. He added a counterbalance: the intricacies and methods of bringing medical devices to the market, the complexities of the health care landscape, and the structure of the sector, with its mix of hospitals, surgeons, payers and manufacturers, show there is a lot more to the medtech industry than just factoring in digital capabilities.

Current Trends In Medtech VC Investment

That was also clear at the 2020 LSX World Congress (4-5 February in London, UK), a forum for investors and life sciences innovators on leading industry themes, such as the medtech value proposition, M&A trends, commercial leadership and movements in the healthtech investment landscape.

Medtech has seen persistently strong investor interest and opportunity in the cardiovascular segment, said Swiss-based venture fund VI Partners' Arnd Kaltofen and Panakès Partners' Alessio Beverina, two participants on an LSX medtech investor panel.

There is a growing interest in robotics, which has become a major trend segment, with "four or five" major companies developing surgical robotics. But investors must proceed carefully here. Kaltofen said his firm had not yet found a robotics deal that it could be comfortable with. Electrophysiology and the convergence of tech and devices were other investment opportunities for his firm to consider.

Lightstone Ventures' Caroline Gaynor agreed that a glut of connected device technologies were coming to the fore, and the was a clear move towards more preventive medicine. She predicted that prevention is going to be "huge," and also highlighted a trend towards chronic care management packages. She added, The key was to cater for what insurance companies look for. "We are still seeing good deal flow," she said," but they are at later stage."

Looking at Europe specifically, Beverina observed that there has not been a "huge amount" invested in digital therapeutics, whereas there is a discernible trend towards that in the US. High-Tech Gründerfonds' Martin Pfister offered a similar view, saying his nine digital health portfolio companies find Europe hard to access because of the differing health care systems used around the continent.

Beverina was also somewhat downbeat on diagnostics, which in his view, did not seem to attract investors in large volumes. However, he noted great interest in the detection of sepsis, a huge burden for national health care systems.

Identifying the growth markets is seemly becoming clearer. OrbiMed Advisors' Anat Naschitz said the trick was gauging the number of people a company could access with its therapy. "The big medtechs are realizing that it's about 'touching' patients – companies that touch patients are more scalable, those that touch clinicians are less scalable."

"The IPOs that happened in 2019 were mostly around home care," she said. "Care is going into the home, and hopefully that's where this industry is going." Patient interaction with devices is a key factor, and devices offering this facility are setting the pace. Patients want smaller, easier-to-use devices that are less intrusive in their lives. But with cost of goods and cost-to-patient, a crucial ratio is at play: to drive and maintain patient adoption, prices must be appropriate and affordable to patients – manufacturers must broach that affordability challenge.

Management Skills A Vital Component

Companies wanting to attract investment need a very clear financing strategy and a very thoughtful management that either understands the needs immediately or has the ability to comprehend and adjust as the company progresses.

OrbiMed wants "the full package," which means looking for a team that can execute and has a clear understanding of regulatory and reimbursement pathways. Pfister noted that investors sometimes saw the need to bring more experienced executives into a company. Precommercial companies often needed to add management skills, he said, as they are "good at some things, but not always at ramping up sales."

Mardle noted the double benefit of this. "Talented, quality people not only bring themselves, but access to capital too," he said. They use their contacts to put together equity rounds that otherwise might not have been possible. "In such a capital-intense world, that can only be a good thing for early-stage and growth-stage companies," he added.

Goodwin itself has recently strengthened its life sciences team in Europe, with Mardle and McGrath joining the London office in 2019 and 2018, respectively. The

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>
> SOPHIE MCGRATH

expansion has given the firm what Mardle claims is the best and largest tech and life sciences team in Europe offering legal service to emerging growth companies and those that invest in them.

Silicon Valley Bank's (SVB) UK head of life sciences and health care Nooman Haque agreed that quality management was of "massive" importance from an investor's point of view. Speaking to *In Vivo*, Haque said investment was all about the people. "No credible investor would invest in great technology if the company had an inadequate team." This is because the path for innovation is so uncertain, and so much can go wrong along the way. There are no guarantees for anything, but management is a "must-have."

Haque was speaking after SVB had released its *2020 Healthcare Investments And Exits* report, which spoke of device investments in the US and Europe increasing for a second successive year, led by large, late-stage deals. While in 2019, medtech M&A had one of its weaker years for deal values, IPOs – eight in number – set new highs in pre-money values and proceeds, SVB reported. It predicts medtech IPO activity will be strong again in 2020.

Investment dollars in devices in 2019 increased by 15% and 43% compared with 2018 and 2017, respectively, according to SVB. In healthtech, devices with a software element and health care software jointly increased by 13% and 95% over the same periods. In many segments of medtech, it is increasingly rare that a standalone device does not have a digital component. There are exceptions, for example, there is yet to be a catheter that provides information on real-time blood flows. But it is probably only a matter time before this happens.

SVB's report valued VC deal activity in European medtech at $907m in 2019, up from $538m in 2018. This was skewed somewhat by two big "outliers," Babylon Health ($550m series C funding) and CMR Surgical Ltd. ($240m series C). "But strip those away and there is still a cascade effect," said Haque. The bigger trend is that technology investors, who never used to invest in health care, are now looking at driving health care investment returns in their portfolios, and through a channel that they understand – digital. That shows a convergence on the investor side, as well as on the technology side.

Haque said, "I still don't expect to see a healthtech investor invest purely in medtech, but if it's led by a digital component as a key part of the economic model, then that is something they'd be more attuned to getting into." Conversely, if the digital element was a bolt-on afterthought on a tangible medtech product, then it would be harder for a tech investor to address.

US medtech investments rose by $400m to $4.02bn in 2019. A significant amount of this was in "enabling technologies" – workflow and data management tools, security, etc. – as well as in the more front-facing technologies, and patient-doctor apps, etc.

As to which individual medtech segments are benefiting most, Haque said: "The increase is across the board." The US, in particular, realizes that there needs to be more investment in "efficiency" and in infrastructure components, where he said there has been "a bit of an uptick."

Goodwin's McGrath observed that a lot of investment is going into digital platforms, such as online treatment forums, professional telemedicine platforms and online interfaces for mental health users.

IPO Or M&A?

The received wisdom on product launches has for a long time been "Europe first, US later." But that might be changing. And most of the recent medtech IPOs have been in the US. IPOs are one route to liquidity, but the major option in Europe remains the M&A route.

Investors across the board are now seeing the M&A market as waiting a little longer before offers are being made for the younger companies, Naschitz said. She observed that, while private equity (PE) has always complained that the public corporates went in too early for M&A plays, leaving little, that is now changing too.

In addition, consolidation of the industry is narrowing the landscape of buyers in traditional medtech for exits of, say, between $300m and $500m, sometimes to just three to four companies per deal.

McGrath said Goodwin had seen a lot of activity in private investment across the whole sector – medtech, digital and biopharma. "It is certainly a very strong funding environment at the moment," she said. For her, how the exit market pans out this year is one of the big questions. Others are what will happen in the US IPO market, and whether M&A comes back to fill the breach potentially created by more challenging public markets?

There has been much talk of medtech companies' valuations being high, and a perceived wisdom that rounds are currently overvalued. But McGrath feels that the overvaluations are the outliers, and that a lot of "right-pricing" is being seen.

With low interest rates having been the norm for some time, medtech is being seen as a safe haven, with its growth upside, and biotech and discovery being seen as more risky. There is consequently pressure to invest in medtech and digital, from the pension funds' governance point of view. Many new funds have been set up, meaning there is a lot of money out there looking for good homes, according to Goodwin.

M&A Outlook: Bolt-Ons To Continue

There are still opportunities for larger mergers but medtech players are now being very thoughtful about where they want to succeed, what to divest and whether to acquire in more core areas. Whether mega or mid-cap, medtechs are regularly looking to see if they have non-core assets.

While mega-mergers are hard to predict, bolt-ons – adding adjacencies – will still be a factor in the next 12-24 months.

Bolt-ons are a way of addressing how a company can ensure sufficient product to distribute through often sophisticated sales and distribution channels. Stryker, for instance, is active in the M&A market not only to identify central acquisition targets but also to diversify into areas that are not so obvious.

But how do such groups find growth in a field where acquisitions are becoming more difficult? The chase for growth is the biggest and ultimate aim, and putting capital to work in ways that will leverage growth is, as most medtechs see it, the whole game.

M&A has always been a major component of the industry, and both the devices industry and the investment community have come to view the medtech sector as a growth engine. The accepted wisdom is that companies in this space should be able to grow in the mid-single digits, and much higher, currently, in the case of surgical robotics manufacturers.

Surgical robotics help to move people out of hospital much quicker, thereby transforming the delivery of health care at all levels, said Mardle. It continues to generate investor interest, even though the high upfront costs can be off-putting. Some technologies can be financed through opex (operating expenses) rather than capex (capital expenditure) in most countries. This offers greater budget flexibility, suggesting that these technologies could find it easier to get sales traction.

"There is huge potential in the displacement of humans as providers of care," said Mardle. The question with robotics is whether people are truly ready to accept the proposition of "taking the human out?" Robotics are a long-term proposition and the potential is still significant. A lot of capital going into robotics is actually "impact capital."

Impact capital is increasingly important for digital health propositions that focus on "mission-based" digital health wellness – rather than clinical care – enterprises which are socially- as well as commercially-driven, and address gaps in the market where pure private sector plays may not venture, due to lack of returns. Pure profit is not the sole aim of impact capital. "It's a sector that attracts people with social concern," said Haque, and capital seems to be responding.

Do Macro Factors Impinge On Investment?

The EU Medical Device Regulation (MDR) will come into effect on May 26 and has begun to cause mild-to-severe panic in some quarters, with observers fearing seriously negatives effects on innovation, company portfolios, companies' continued viability even, and the delivery of patient care. But Mardle believes that experienced investors will be more sanguine, taking the long view.

Haque added that it might happen that less experienced investors, who see in the MDR longer timescales and harder processes, back away. The fundamental question for him is: Does the landscape shift such that it does not make investor propositions feasible within the time frame of a fund? Many funds are 10-year vehicles, but if the MDR, say, doubles the regulatory timescale, then there might be huge implications for venture investors. The jury is still out on that.

Mardle's view is that the impact of MDR will be assimilated – albeit not without its chaotic moments – based on the significant weight of capital invested. As to Brexit's impact on the medtech industry, the UK is an established center of innovation and it seems probable that "it will retain that position," said Mardle, and will not be harmed irreparably.

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Similarly, the US 2020 election is unlikely to have a material impact on early-stage investment. The market had managed an election every four years, said Mardle, who suspects that the outcome in late 2020 will drive any long-term trends. "We haven't seen any indications that people in this sector are changing their investment decisions over it." Investors fund great technology and great management teams, regardless of where they are physically located; and, because of the long lead times for commercialization, they are often not so focused on macro issues, especially in the earlier stages.

"So long as interest rates remain low, we see no reason why the capital flows into innovative medtech won't continue very strongly, with large amounts coming from the US and China," said Mardle. China is going through unusual times at present, with the Covid-19 virus disrupting normal business procedures, but in general, demand for improved patient outcomes in China is immense.

And the expectation of investment in healthtech is large. As such, the current coronavirus crisis is expected to drive those trends, not mitigate them. China has its own technology scene, with local rivals to the US-based global tech giants, but it's still an opportunity for investment.

The Long View Is A Priority

For the big corporates, the long view is the priority when balancing in-year operational issue with strategic growth initiatives. Back at the LSX World Congress,

Medtronic PLC's VP, strategy and business development, EMEA, Charity Kufass, said while there is so much uncertainty in the world, "we run the business in such a way as to focus on the long-term strategy and what we need to achieve."

J&J company group chair of medical devices, EMEA, Hani Abouhalka, agreed: "Industry factors are not impacted by events in a one- to two-year cycle. There will always be shocks along the way, and we manage for the long-term, as well as using commercial discipline."

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