With initial public offerings a rarity in the medical device sector, a private medtech company has little choice but to look to a company sale to realize value for its investors. Sprawling industry giants, armed with cash and publicly tradable securities, dominate the acquisition market. Knowing this, executives and boards of device companies—whether at an early stage of development or with a well-established market niche—must position their firms as attractive targets for buyers such as Johnson & Johnson, Medtronic Inc., C. R. Bard, and Boston Scientific.

But an emerging medical device company, even one with exceptional promise, must clear many hurdles to position itself for sale to a global giant. Even one misstep along the way can prove fatal to the ultimate acquisition.

The Process of a Sale

Some device companies, even at the start-up stage, deliberately select venture investors, scientific advisory board members, and professional advisers who have their eye on an exit. They surround themselves with people who have established networks and relationships with potential buyers. These allies can bring instant credibility to a new company, and can be valuable resources when an exit is pursued.

A company sale is a process, not an event. Building awareness among the industry giants can take several years, and seeds need to be planted early through trade show exhibits, presentations at investor conferences, and product testimonials by clinicians. The required networking often involves many hours of milling around in hotel ballrooms, where prospective sellers can rub elbows with group leaders, marketing professionals, and division managers of the conglomerates.

Executives of private device companies sometimes ask whether a minority investment, distribution arrangement, or codevelopment relationship with an industry giant is a logical first step toward a sale. The answer is usually ‘no.’ Unlike the biotech industry, to name one example, there is no history of successful collaborative arrangements in the medical device sector.
Very few distribution or codevelopment deals are executed in the medtech sector because big device companies need to maintain complete control of quality standards and are wary of being the deep pocket. Before a major device company will distribute a technology developed elsewhere, it will perform the same due-diligence review that is required before an acquisition. This can make a distribution arrangement nearly as time intensive and costly as an acquisition. What’s more, the companies’ different agendas, time lines, and abilities to make further investments create misalignments that compound the risks to both sides.

A device company can be ripe for sale once it has assembled a critical mass of intellectual property, clinical data, and regulatory approvals. Buyers look at not only an acquisition target’s patent portfolio, but also whether there is sufficient freedom for its technology to operate and be integrated with other products without infringement. They also look for a combination of proprietary intellectual property and regulatory approvals that creates barriers to entry by other companies.

Because there are very few business development professionals who have the background needed to understand the world of animal data, it is difficult to gain serious interest among buyers for a device or technology without human clinical data. However, once human clinical data are established, a global giant can readily assess a technology’s value. Given its own marketing and sales expertise and far-reaching distribution capabilities, a company looking to make an acquisition may sometimes be less interested in whether the product is currently generating significant revenues than it is in having access to the seller’s clinical data.

Finding the Decision Makers

Finding the right entrance to a major device company can be daunting, and sometimes it is difficult to identify a company’s real decision makers. Global firms receive dozens of business plans every month, and cold calls rarely make it onto priority lists. Executives who build direct relationships over time with persons of influence have a significant competitive advantage. A nonconfidential executive summary that succinctly captures a target’s potential and can be e-mailed within the prospective buyer’s organization can be an effective tool for finding the right audience.

“You do not want to blindly pick up the phone and call someone listed on a Web site,” says David Milne, a partner at the venture capital firm SV Life Sciences (Boston) and former vice president of business development at Boston Scientific (Natick, MA). “Once you are in the door and have been turned down by the wrong person, it is hard to get back in again unless you are going to run that person over. And then you have someone working against you. I have also found that the most challenging way to get into a company is through the marketing people, since they usually have 10 other priorities.”

At some medical device giants, such as Medtronic (Minneapolis) and Boston Scientific, the business development group operates at the corporate level and serves all of the company’s operating divisions. Other companies embed deal-doers within their various divisions. In all cases, it is essential to establish an ally at the operating level who understands the clinical applications and technologies, and can act as an internal advocate.

Richard Dakers, vice president of business development in the medical devices and diagnostics group at Johnson & Johnson (J&J; New Brunswick, NJ), reports that J&J’s internal evaluation process for a potential acquisition almost always begins at the division level. Once the business unit approves the opportunity, it moves on to the corporate business development and finance groups. There is then a continual interplay between the corporate and division levels. “You are not going to put a $100 million acquisition in front of J&J senior management and get it approved in a 10-minute conversation,” Dakers says. “They will want to understand the technology, strategic fit, and the integration plan, and ask the operating proponents whether they really know what they are getting into. There is a lot of back and forth.”

In large companies, acquisition proposals are presented to different audiences at the division and corporate levels, and each audience evaluates the target in a different light. The division has to support the acquisition because it will be selling the product, while the corporate office needs to crunch the numbers and convince executive management and the board that the transaction makes sense. Even in the largest organizations, individuals with their own reputations on the line—not faceless companies—make the deals.

The Art of Presentation

Management presentations offer a critical opportunity to influence a potential buyer’s decision makers. At its core, a presentation should focus on the technology’s value, potential for profitable commercialization, and how it can further the buyer’s strategic objectives. A presentation to a strategic buyer often requires more preparation and detail than a presentation to a financial investor. Division managers at a major device company are likely to begin with an under-
Building awareness among the industry giants can take several years, and seeds need to be planted early.

have the maximum clinical effect with the highest immediate reimbursement and the greatest share of a billion-dollar market, I get nervous,” says J&J’s Dakers.

Often there can be a mutual sharing of data that bridges gaps and educates both sides. “If you do not have a realistic dialogue, there is never going to be a deal,” says Bob Mellen, vice president of strategic planning and business development at C. R. Bard (Murray Hill, NJ). “You need to have that dialogue to get on the same page, or to at least agree to disagree.”

A management presentation should demonstrate a deep understanding of the product’s market, including the specific market that is available for a precise clinical result. Although corporate buyers will conduct their own technology reviews and market assessments, a target company can speed the process by anticipating questions. A target should be prepared to answer questions before a buyer has an opportunity to form an incorrect opinion.

During the due-diligence stage, a seller can set up a separate password-protected online data room to house documents and give potential buyers a CD-ROM of indexed materials to take away under a nondisclosure agreement. A standard due-diligence checklist that transaction lawyers can provide is a good starting point for organizing that data. For a medical device company, it is particularly important to include clinical findings, patent filings, and regulatory submissions.

Global medtech companies typically track acquisition activities in their own organized fashion, with regular updates to senior management on transactions in the pipeline. Once a proposed acquisition is in the pipeline, most business development managers are receptive to periodic inquiries from prospective sellers on deal status and welcome ongoing updates on areas of major progress. Ultimately, transparency and cooperation on both sides are what speed the acquisition process.

Determining a Company’s Worth

Valuations by corporate buyers invariably begin with a conventional analysis of discounted multyear cash flows and a recitation of comparable transactions selected by the buyer. In constructing the cash flows, assumptions will be made as to expected patient populations, anticipated clinical results, and competition. An acquirer will also consider what expenditures will be required for FDA approvals or further product development.

The most attractive acquisition targets combine a good business model, such as high gross margins or recurring consumables, and either a strategic fit critical to the acquirer or an initial entry into a business segment in which the acquirer seeks a presence. A seller can also maximize value in the eyes of the acquirer by indicating the results that can be achieved through the deployment of the buyer’s vast distribution channels.

Earn-out payments based on milestones such as regulatory approvals, first commercial sales, or product revenues can bridge valuation gaps. Many companies, including J&J and Boston Scientific, have a history of transactions that include earn-out payments. However, large companies will want to control the direction of the acquired business during the earn-out period. This can be at odds with the seller’s continuing financial interest. A big company may also seek to cap earn-out payments to limit the scope of potential liability if a dispute over the earn-out arises.

The earn-out agreement is not the only matter of postclosing financial concern on the part of a seller. The ultimate realization of value can be affected by the application of escrowed funds, ongoing indemnities, and the seller’s ability to convert any of the buyer’s securities it receives into cash.

“The fact is that buyout prices have not changed much in the last five years in the medical device industry,” says Milne of SV Life Sciences. “A transaction in the range of $100 million to $150 million is pretty typical, depending on the stage of regulatory approvals. After the venture investors and option holders are taken care of, I rarely see founder-CEOs winding up with more than 5% of the equity at the time of sale.”

Conclusion

For the major device companies, the ability to identify promising
acquisition targets that can provide vehicles for growth is a crucial component of their business. Every major player devotes considerable resources to in-house business development, finance, and due-diligence professionals who complete transactions on a continual basis.

For executives of an emerging device manufacturer, a company sale can be a once-in-a-career occurrence, and requires plenty of thoughtful planning and the ability to identify the right prospective buyers.

The bottom line is the big players are always looking for growth platforms that will enhance or add to their existing business lines. They are searching for that next great product or project just as fervently as emerging companies are trying to get their attention. In the end, the matches that promise strategic advantage, the potential for real value over time, an ability to leverage the technology across product lines, and carefully protected intellectual property are the deals that will come to fruition.

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