# Latest on the Consolidation Front – M&A in the Spine Sector

*Interview with Bob Kinsella, President of Kinsella Group, and Don Urbanowicz, Urbanowicz Consulting*

By Don Urbanowicz
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On October 25, 2016, Capital One, BioMedGPS and Kinsella Group sponsored a panel discussion prior to NASS 2016. Multiple panel members participated in the event which covered a variety of topics. The discussion featured in the excerpt below focuses on "The Latest on the Consolidation Front – M&A in the Spine Sector" with Bob Kinsella of the Kinsella Group and Don Urbanowicz of Urbanowicz Consulting.

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**Robert Kinsella**
*Kinsella Group*

**Don Urbanowicz**
*Urbanowicz Consulting*

**Don Urbanowicz** : I'll be talking about the latest on the spine consolidation front, conducting a Q&A with Bob Kinsella, and then taking a question from the audience.

So what is this "urge to merge" in healthcare about? Consolidation has not only affected medical device OEMs and suppliers, but hospitals, physician groups, and insurers as well. There are a number of reasons including: the Affordable Care Act, which has triggered changes within the medical device industry and resulted in companies scrambling to cope. In addition there is a belief that scale and portfolio breadth matter, especially when fighting for vendor agreements with hospitals. It's a response to a mature and declining price environment where scale – at least in theory – provides offsetting cost benefits. Finally, credit has remained cheap and there are still a group of companies who have pretty robust balance sheets.

> *"Consolidation is a response to a mature and declining price environment where scale – at least in theory – provides offsetting cost benefits."* -Don Urbanowicz

On the spine side, (See Appendix 1), there's been pretty strong M&A activity so far in 2016 – more so than 2015 and 2014. Consolidation in spine has resulted from the overall maturity of the space, the quest for scale by the strategics, and the fact that there are more publicly traded companies. To the latter point, BioMedGPS tracks the number of spine hardware companies worldwide, and that number totaled 245 as of this morning. They also track the number of publicly traded spine hardware companies worldwide, and that number is 23, of which 13 are US publicly traded companies and one – LDR – was recently acquired by **Zimmer Biomet**. Historically, when the number of publicly traded companies increases in a particular med-tech space, consolidation follows. What we may be seeing are some of the companies that went public over the past several years like **Globus**, **Bacterin/Xtant** and **SeaSpine**, who have become more active on the acquisition front – as well as other publicly-traded companies who have recently been acquired themselves. There were eight transactions, at least by my count, through August 2016, twice the total number during 2015, and four times the total number in 2014.

The complete list of the 14 transactions are included (See Appendix 2). A few takeaways: First, two of the transactions were robotics focused, and that included **Globus**' acquisition of Excelsius in early 2014, and **Zimmer Biomet**'s acquisition of Medtech SA mid-year, 2016. However, it excludes **Medtronic**'s recent equity investment in **Mazor Robotics**. The second take away is that although I have not posted sales multiples, there has been a wide disparity, and in July 2016 alone, we hit low and high watermarks. Specifically, Globus bought **Alphatec**'s international business for a shade over one times sales. On the other hand, in that same month, Zimmer Biomet acquired **Medtech** for an estimated 10 times sales. If you're thinking that's a high multiple of sales, to put it in perspective, previous successfully concluded transactions for robotics companies, including **Stryker**'s acquisition of Mako, and **Smith and Nephew**'s acquisition of Blue Belt, were closer to a 14 times sales multiple range. One last take away is the fact that of the 14 acquisitions, and again my list is not exhaustive – it simply includes transactions that have been made public – 13 of the 14 transactions were completed by strategics. There is one private equity firm, Kohlberg & Company, who acquired **Amendia** in May of 2016. We'll discuss with Bob if that's a one off situation, or if were going to see more private equity activity, not only in spine, but in orthopedics in general.

Let me conclude by offering at least some of what the BioMedGPS analysts have been hearing prior to NASS. On the revenue side, it will be slow, steady growth going forward with procedural volumes stable, and with optimism in the short term for slight procedural volume improvement. Pricing pressures will continue to be the new norm, but the rate of price erosion has remained steady. Not surprising, they'll be a huge buzz on the NASS floor regarding robotics, especially with **Medtronic**'s equity investment in **Mazor**, **Zimmer Biomet**'s acquisition of **Medtech** and **Globus**'s acquisition of Excelcius. From BioMedGPS's standpoint, they are actually more curious about the future spine robotics strategies for three other companies. One is **Stryker**, the other is **Nuvasive**, and the third is **J&J**, and incidentally, of the five largest orthopedic companies (Stryker, J&J, Zimmer Biomet, **Smith & Nephew**, and Medtronic). J&J is the only one without a commercial robotics platform in either hip, knee, or spine.

> *"From BioMedGPS's standpoint, they are actually more curious about the future spine robotics strategies for three other companies. One is Stryker, the other is Nuvasive, and the third is J&J, . . . the only one without a commercial robotics platform in either hip, knee, or spine."* -Don Urbanowicz

The final two spine-related points to make include the growth of out-patient procedures and greater visibility for value-based care. Due to reimbursement and improvements in technology, including MIS, inpatient procedures are shifting to a less acute setting. In addition, there is a movement away from fee-for-service to a value-based or bundled payment. There is some talk about spine following the current bundled payment model currently being piloted for hips and knees, and we should all pay careful attention.

At this point, I'd like to ask Bob to introduce himself, and talk a little about his company.

**Bob Kinsella**: Kinsella Group is a boutique investment bank located in Chicago with a focus on medtech and medical devices. The Group is supported by an Advisory Board made of up industry veterans who are segment specialists. In addition to NASS we regularly attend Medica in Dusseldorf, Germany, AAOS, MD&M shows and Medtech Europe in Stuttgart, Germany. We are increasingly representing clients with cross border M&A interests spanning the US and Europe.

**Don**: Bob, I promised a question on the private equity side. We saw one transaction done this past year by a PE firm (Kohlberg acquiring **Amendia**), is this is a one off? Is this going to be something that we'll see more frequently in orthopedics and spine specifically?

**Bob**: Let me back up to answer that question. We have been showing private equity firms spine companies for at least five years and there have been very few takers, not much interest. And we were always told that distribution was a problem. How are you going to rationalize these distribution systems when you've got independent reps who have relationships with one or two surgeons and they maintain those relationships, how do you scale that, how do you get a bigger company? Well, what we've seen is that there have been some spine players who said well we'll go and have our own exclusive reps. **K2M** has done that. **Globus** has done that, and I can only believe that Kohlberg now has in their own mind come to a similar conclusion. I don't know that for sure but this is the only reason I can think they would have stepped up to do that. So with that, I believe, we will now see other private equity firms entering the market, which can only be good, in terms of valuations, and always an issue with private equity. It can only be good in terms of creating more opportunities for spine company owners to exit.

> *"I believe, we will now see other private equity firms entering the market."* -Bob Kinsella

**Don**: Have you heard anything about Kohlberg looking into buying additional assets to complement the **Amendia** acquisition?

**Bob**: Oh, yes, they are very active in the marketplace. I don't know that they're going to be able to duplicate the way **Amendia** has done some of those deals, and I don't think I'd be offending them in any way by saying some of what they've done have been distressed assets, and so you can do different things with distressed assets that you can do with profitable well-run companies. So, I think their model is going to have to change a little bit, but I think they're aggressively going after other opportunities in the marketplace.

**Don**: Another follow up for you, Bob. We've got some suppliers in the audience, so tell us what's happening on the supplier side of the business. We talked about accelerated deal making on the spine OEM side, but what's happening on the supplier side?

**Bob**: We know of eight active transactions – non-auction opportunities right now – three of them in Europe, with the balance in the United States. These are lower middle market companies with revenues of about $25 to $75 million, with active discussions regarding prospective acquisitions. So I think between the fourth quarter of 2016 and first half of 2017, I think you're going to see a lot of transactions on the supplier side.

**Don**: Bob, one final question and we can then field a question from the audience. So, you're aware of the Tecomet/Mountainside transaction that just concluded. What's your take on the strategy behind the deal? Why Mountainside?

**Bob**: Well, just a word about Mountainside. Nice company from what I understand. We did not represent them in the transaction, nor did we represent Tecomet. But it is a company with a pretty significant concentration with one customer, but Mark Kemp, the CEO of Tecomet, told me that his rationale was to move into minimally invasive surgery. That was the gap in Tecomet's portfolio and he thought that was where he needed to do a deal. And there were other people who looked at it, but he stepped up and paid up to do that transaction.

**Don**: Any questions?

**Question from Audience**: Don, earlier you asked a question if the Kohlberg-Amendia transaction was a trend or a one off event. And as you know, I've been heavily involved in a number of spine and orthopedic companies that have attracted significant private equity interests. In fact, last week we just signed a letter of intent on a spine company with a private equity group. So my question to Bob is that one of the things that is the most challenging with an entrepreneurial company and a private equity group is valuation. And typically the strategics are more aggressive and have the opportunity for greater synergy, so there's always the edge of greater valuation with the strategics than the private equity. Do you think that private equity can overcome that, and what are some of the possibilities and challenges that can be overcome?

> *"Private equity and strategics do not see things in the same way. A strategic is buying, in our view, for the long term. There is no exit."* -Bob Kinsella

**Bob**: Well first of all, hats off to you. I mean congratulations on getting that done. That's no small task. Private equity and strategics do not see things in the same way. A strategic is buying, in our view, for the long term. There is no exit. It's added to their business and many times what they're doing is adding a product to a distribution channel they already have in place. So, it's all additive. Private equity, on the other hand must rely on the investment to stand on its own if this is to be a platform investment or integrate with an established platform all with an eye to an exit. I mean the closest thing in our mind to the strategic, from a money source, are family offices who will hang in for a longer period of time, and not be looking for a near-term exit. So, the private equity that we've seen wants to get in and they want to know what their exit is. The private equity firms we've interacted with, to whom we have shown spine companies, ask "How do we get out, who do we sell this to?" And if they can't see the exit, they don't want to come in. And of course their financing sources are doing the same thing. They go back to the limited partners to raise more money. Their debt sources are asking that question too. Okay, well how do you get out? How are we going to get paid? So I think those are very, very tough questions, and Kohlberg coming in obviously has thought it through. And whomever you signed with has thought it through, and they've got some notion of where they're going to exit. But I would say, if they think it's going to be automatic, they're going to scale up and exit to a strategic, I'd be skeptical.

**Don**: I'd like to thank Bob. We hope to see many of you again at our pre-AAOS reception tentatively scheduled for Tuesday evening, March 14th, in San Diego.

| # of Transactions (2014 vs. 2015 vs. Aug, 2016) | |
|---|---|
| **Transactions** | **Spine** |
| Through Aug 2016 | 8 |
| 2015 | 4 |
| 2014 | 2 |

| Date Announced | Acquirer | Target | Transaction Value ($MM) |
|---|---|---|---|
| **Aug 2016** | SeaSpine | NLT | $53 |
| **July 2016** | Globus | Alphatec (International) | $80 |
| **July 2016** | Zimmer Biomet | Medtech SA | $132 |
| **July 2016** | Merit Medical | DFINE | $97.5 |
| **June 2016** | Zimmer Biomet | LDR | $1,043 |
| **May 2016** | Kohlberg & Co | Amendia | N/A |
| **April 2016** | Stryker | SafeWire | N/A |
| **Jan 2016** | NuVasive | Ellipse | $410 |
| **July 2015** | Xtant | X-Spine | $86.6 |
| **July 2015** | Mindray Medical | Wuhan Dragonbio | $143.3 |
| **July 2015** | Amendia | Custom Spine | N/A |
| **Feb 2015** | Globus | Branch Medical | $52.9 |
| **April 2014** | Stryker | CoAlign | N/A |
| **Jan 2014** | Globus | Excelsius Surgical | N/A |