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Special Feature...

**Healthcare Trends:
Medical Device
Outsourcing**

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Healthcare Trends: Medical Device Outsourcing

Throughout the U.S. economy, the trend is toward outsourcing, and medical product manufacturers have begun to follow the examples of their counterparts in other industries and increase the use of outsourcing partners. Original equipment manufacturers (OEMs) are contracting with outside firms for a variety of services that go well beyond traditional deals to produce certain parts or components. Certainly, the emerging trend to increase the use of outsourced work covers those elements, but it also can encompass everything from basic design to marketing. While the services are proving valuable to OEMs, the real benefits will emerge as the market matures.

Although generating some \$3.4 billion in annual revenues and growing over 15% per year, the medical device outsourcing market is still a highly fragmented industry, with numerous companies vying for business and offering various niche services. However, there are signs the industry is heading toward a more organized state. About half of the market is still run by companies that each comprise 1% or less of the available business (Figure 10), but consolidation has clearly begun.

The industry's largest deal took place in June 2004 when UTI (Collegetown, PA) acquired MEDSOURCE TECHNOLOGY (Minneapolis, MN) for \$230 million. Both firms had previously bolstered their positions in the industry by making various acquisitions and the combined company—renamed ACCELLENT in November 2004 and headquartered in Newton, MA—now holds about 11% of this market.

The deal is part of the igniter that will spur other outsourcing companies to become more active in mergers and acquisitions over the next five years and beyond. By 2015, it's possible that the market could be comprised of fewer than a dozen companies, with five dominant players.

Cost Pressures Driving Growth in Outsourcing

The chief reason behind this shift is cost pressure. Manufacturers that take great pride in coming up with a brilliant idea for a product are

often faced with a grim reality when they realize how much it will cost to mass produce that product. Specialized labor can be expensive, and even though many companies try to hold down costs by setting up production operations abroad, there's a limit to how many factories even the largest companies can afford to establish. Moreover, the medical product industry's primary customers, acute-care hospitals, are operating under mandates to reduce supply spending. Therefore, unless a manufacturer is selling the next "must have" item, such as a drug-eluting stent, hospitals are not likely to make acquiring expensive products a priority.

That's where an outsourcing company can come in, offering a more cost-effective means of producing a product and providing factories, staffing, materials, and everything else needed to meet a specific manufacturer's needs. Currently, about 20% of medical devices are being manufactured under outsourced contract agreements, and that figure is expected to grow steadily over the next 10 years. Ron Sparks, president and CEO of ACCELLENT, believes the outsourcing industry could gain as much as 1% of the market per year. Based on OEMs' business strategies, which have an increased emphasis on outsourcing agreements, the 1% per year growth seems obtainable. In fact, manufacturers seem to be ahead of outsourcing companies, and the only thing that might make growth move more slowly is if the outsourcing firms aren't ready to take on more business.

One-Stop Shops

OEMs are looking for one-stop shops, where they can bring projects at any point in development and not have to contract with one firm for design help, another company for parts production, and a third for assembly, for example. ACCELLENT (Figure 11, p. 158) has done its homework and has established a business model aimed directly at fulfilling OEMs' desires, and some of the company's current customers have voiced strong approval of the set up.

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Figure 10: Selected Players in the Medical Device Outsourcing Market

Company	Market Share
ACCELLENT	11%
PLEXUS	6%
HERAEUS	4%
WILSON GREATBATCH TECHNOLOGIES	4%
AVAIL MEDICAL	4%
SYMMETRY	4%
TECH GROUP	3%
LAKE REGION	3%
FT. WAYNE METALS	3%
MEDTECH GROUP	1%
SYNOVIS	1%
CREGANNA	1%
Other	55%

Source: MEDTECH INSIGHT



Figures 11: ACCELLENT at a Glance

Formed:	<ul style="list-style-type: none"> Created in 2004 through UTI's \$230 million acquisition of MEDSOURCE TECHNOLOGY
President and CEO:	<ul style="list-style-type: none"> Ron Sparks, former president of SMITH & NEPHEW's endoscopy division
Company Divisions:	<ul style="list-style-type: none"> Endoscopy (Boston) Cardiology (Minneapolis) Orthopaedics (Boston)
2004 Net Sales:	<ul style="list-style-type: none"> \$320.2 million
Selected Customers:	<ul style="list-style-type: none"> BOSTON SCIENTIFIC GUIDANT JOHNSON & JOHNSON
Services:	<ul style="list-style-type: none"> Complete gamut, from fundamental design to end-user delivery

Source: ACCELLENT

The fact that manufacturers are actually driving the market's development makes it more than a pretty good bet that growth and consolidation are on the way in the outsourcing market. OEMs are counting on it, because competition among medical device companies is now centered as much around time as it is around costs, and bringing products to market faster is appropriately the new industry dogma. The difference between being first-to-market versus second can be millions of dollars in some cases.

Additionally, with the speed of product innovation in healthcare, there's no guarantee devices used to treat a particular condition won't fall out of favor with physicians, or even become obsolete, after a relatively short time.

Much of the future consolidation and other deal making in this industry is likely to be on a market-by-market basis and could be facilitated by large suppliers looking for a competitive edge. A case in point is the recently completed deal between ICU MEDICAL (San Clemente, CA), a proprietary and contract manufacturer of custom and generic medical connection systems for use in intravenous drug therapy, and HOSPIRA (Lake Forest, IL), a large, specialty pharmaceutical and medication delivery company that also houses the U.S.'s leading injectable contract manufacturing business. Building on their existing 10-year relationship, the companies have entered into a

twenty-year Manufacturing, Commercialization, and Development Agreement under which ICU MEDICAL has acquired HOSPIRA's Salt Lake City, Utah, manufacturing facility, related capital equipment, and certain inventories for about \$32 million in cash. ICU will produce all of the products manufactured at the plant (which are primarily critical care products) and HOSPIRA will retain commercial sales, marketing, and distribution responsibility. ICU

will also fund R&D to improve current products and develop new critical care products for sale to HOSPIRA. ICU expects to move production to its current facilities or other lower-cost locations over the next several years.

Advantages for Manufacturers

It's not hard for medical device manufacturers to understand the benefits of contracting out some of their production efforts, especially in today's increasingly competitive environment. Manufacturers need to concentrate on their core competencies—research and development, training, and marketing—instead of production, which can easily and cost effectively be contracted out. The process works for companies that, for example, need to keep up with, or stay ahead of, the competition by producing 20 new products over the next 12 months, but only have a staff large enough to handle half that load. At some point, the realization sets in that instead of spending money to build factories in order to meet their goals, they can outsource much of the work and invest the money saved in sales staff and clinician training, which is becoming more time consuming as newer, more complicated products enter the market.

Although all the big-name OEMs are taking advantage of outsourcing strategies to some degree, the method isn't exclusively for larger companies. Outsourcing also is a way for smaller firms to compete with the top manufacturers without having to secure large investment dollars for infrastructure to produce a product.


PLEXUS (Neenah, WI), the #2 player in the medical products outsourcing market, is an example of an outsourcing firm that touts its ability to work with both small and large manufacturers. Like ACCELLENT, the company has set up a one-stop shop, but PLEXUS' proficiency is in electronic manufacturing services, which includes products such as ultrasound and diagnostics equipment as well as a variety of therapeutic devices and patient monitoring products. PLEXUS, which achieved revenues of over \$1 billion last year (Figure 12), also services other industries besides medical products, typical of electronic outsourcing firms, which deal with a technology that crosses several industry lines. 

Figure 12: PLEXUS at a Glance

Formed:	<ul style="list-style-type: none"> 1980
President and CEO:	<ul style="list-style-type: none"> Dean Foate; has been with company in various roles since 1984
Fiscal 2004 Revenue:	<ul style="list-style-type: none"> \$1.04 billion
Fiscal 2004 Q4 Sales by Divisions Served:	<ul style="list-style-type: none"> Networking/Datacom – 43% Medical – 33% Industrial/Commercial – 15% Computing – 4% Transportation/Other – 5%
Selected Customers:	<ul style="list-style-type: none"> SIEMENS MEDICAL KENDALL COMPANY GENERAL ELECTRIC
Expertise:	<ul style="list-style-type: none"> Electronic Manufacturing Services (EMS)

Source: PLEXUS