

Orthopedics • This Week

Symmetry Medical's Monumental Bet

By Robin Young

Last week Warsaw, Indiana-based Symmetry Medical Inc. (SMA) announced that it had won the bidding contest for Johnson & Johnson's (JNJ) Codman & Shurtleff business.

This is SMA's second major purchase from JNJ. Three years ago the company paid \$45 million for DePuy's New Bedford, Massachusetts, manufacturing facility. For Codman, SMA paid \$165 million and as a result receives one of the most respected and well known instrumentation brands in orthopedics. It also puts the company squarely into the direct-to-hospital business. Very interesting move for the largest private label supplier in orthopedics.

And then there's the price. Symmetry, a company with a total market value of \$285 million, paid \$165 million *cash* for Codman. That is a monumental bet by any measure.

The Evolution of Symmetry

SMA sells instruments, implants and other products to such orthopedic device manufacturers as Biomet, Inc.; DePuy, Medtronic, Inc.; Smith & Nephew plc; Stryker Corporation and Zimmer Holdings Inc.. Outside of orthopedics SMA sells to Cardinal Health, Inc.; Karl Storz GmbH & Co. KG; Edward Lifesciences LLC and St. Jude Medical, Inc.. In the custom manufacturing world of hips, knees, spine, shoulder and trauma, Sym-



Source: Morguefile and pppdigital/ Symmetry Medical, Inc./RRY Publications Photo Creation

metry's \$365 million in annual sales makes it the largest supplier and the only public private-label orthopedic manufacturer.

Last year, SMA's three largest customers were DePuy (31.7% of sales), Stryker (10.5% of sales) and Zimmer (10.0% of sales).

Between 2006 and 2009 Symmetry bought seven companies. In total they paid \$180 million for these firms. Until last week, the biggest purchase was DePuy's New Bedford instrument manufacturing facility.

Symmetry is now about 35 years old. The company opened its factory doors in 1976 to supply surgical instruments

to its neighbors, the Warsaw gaggle of orthopedic device manufacturers. By 2004, when orthopedic companies were the darlings of Wall Street, the company had grown to about \$200 million in sales and decided to sell a little over half of its stock to the public. Shortly after the IPO, SMA bought Riley Medical and Everest Metal Industries. Riley gave SMA additional lines of cases and trays and several new patented products. Everest gave SMA an expanded ability to finish implants for SMA's core orthopedic manufacturer customer base.

In 2007 management decided to buy four more companies—Clamonta Ltd., TNCO, Inc., Specialty Surgical Instrumentation, Inc. and UCA, LLC.

Clamonta gave SMA a way into the global aerospace industry and some very high tech production capabilities. TNCO, which had been designing and supplying instruments for arthroscopic, laparoscopic, sinus and other minimally invasive procedures for more than 40 years, improved SMA's design capabilities AND continued SMA's pattern of diversifying out of orthopedics. Specialty Surgical Instrumentation, Inc. and UCA, LLC (collectively "SSi") which are based in Nashville, put SMA squarely in the direct-to-hospital market.

SSi, in retrospect, was a key strategic move by SMA's management. Not only did SSi add about 13,000 new surgical instruments and sterilization SKUs, it also established a beachhead for SMA in the direct-to-hospital market. With SSi, SMA was now selling directly to about 1,000 customers, several of whom owned multiple hospitals.

Then in 2008 SMA bought DePuy's New Bedford instrument manufacturing facility for \$45 million. One of the key elements of that deal was the provision that DePuy buy at least \$106 million in *incremental* product from SMA between 2008 and 2012.

Think about it. SMA paid \$45 million for the New Bedford facility but got 2.35x that amount back in *incremental* purchases.

Who Are These Guys?

Eight people make up Symmetry's executive management. Their average age is 49 years old.

Leading the team as President and CEO is Tom Sullivan (48 years old). Sullivan joined SMA just this year. For the previous four years Tom was JNJ's president of the Supply Chain & Business Process division for the Health Care Systems unit. Before that he had been president of DePuy Orthopaedics (2005 to 2007) and president of Johnson & Johnson Medical Products Canada.

Sullivan took over the CEO reins from Brian Moore (65 years old) who serves as the company's president of Business Development. Moore joined SMA eight years ago and until this year, was SMA's president and chief executive officer. Moore has worked in a wide variety of industries including aircraft, precision engineering, automobile manufacturing, brewing and insurance.

Rounding out the executive team are six other individuals from a similarly wide variety of non-orthopedic industries. In short, this is a group that is very comfortable with the concept of industrial diversification.

To this former Wall Street analyst, SMA is looking more and more like an industrial roll-up company.

Symmetry & Codman = ?

What is Symmetry buying for its \$165 million?

First, it's acquiring about \$60 million in new sales which, when added to SMA's current hospital-direct business, Specialty Surgical Instrumentation (SSi), pushes the hospital-direct business at SMA to \$100 million in annual sales (that's about 25% of the total). But SMA also bought several outstanding brand names.

Codman's BOOKWALTER brand of table-mounted retractors, which are considered standard of care for abdominal surgery, is probably the strongest of the Codman brands. SMA also picks up OPTI-LENGTH, QUAD-LOCK, RAPIDCLEAN, CLASSIC PLUS and



Wikimedia Commons and 2bgr8

CLASSIC, GREENBERG, KARLIN and MAGNAFREE.

SMA is also getting Codman's 60+ country sales and distribution network. When we asked Tom Sullivan about this he said: "We are particularly excited about the regions of Asia, Middle East, Africa and South America. Everywhere there are new hospitals being built, the Symmetry Surgical (SSI) brand will be there and we look forward to being a part of advancing patient care in these new geographies."

Codman main markets for its instruments are spine surgery; general and OBGYN surgery; microsurgery and neurosurgery; and cardiovascular and thoracic surgery.

So, specifically, how does Codman grow as part of SMA? Sullivan answered us with: "SSI has proven that it can grow double-digits by gaining market share in the surgical instrument market. When combined with the surgical instruments business of Codman, Symmetry Surgical will have stronger direct and distributor sales channels, a larger international presence, particularly in Asia and Latin America, and a broader product portfolio. We expect to continue to deliver faster than market growth in Symmetry Surgical over the long run."

As a supplier of orthopedic instruments at, essentially, wholesale prices to the Stryker's, Zimmer's and Smith &

Nephews of the world, SMA's operating profit margins have always been about one quarter as high as its customers. This year, for example, SMA's operating profit margins are coming in at between 6% and 7% of sales. Zimmer, Stryker and Smith & Nephew's operating margins, by contrast, are between 22% and 28% of sales.

This is the difference between selling at hospital prices and selling at wholesale prices.

CEO Sullivan, indirectly, addressed this when he commented to *OTW* about the financial effect of the Codman purchase. "On a consolidated business level, the expansion of Symmetry Surgical to ~25% of our overall revenue adds diversification, has a positive impact on our gross margin and operating margin, and is synergistic for our core orthopedic OEM supplier customers, which represent ~75% of our revenue. We also expect Symmetry Surgical to generate significant free cash flow with minimally capital investment requirements. In 2012 we expect the transaction to be breakeven on GAAP EPS basis and significantly accretive on a cash EPS basis."

Wall Street Isn't Paying Attention

Wall Street isn't paying attention. For the past three years, the stock has been in the doldrums. These days it trades between \$7 and \$9 per share or \$250 million and \$325 million.

In 2008 the stock traded as high as \$18 per share (\$650 million).

But we've seen this pattern before. With this and its other purchases, SMA has all the appearances of building steam for, we think, an aggressive move into new markets, higher margin products and with this young team in place, a steadily rising rate of sales growth.

Basically, SMA is dropping the image of a staid, low margin supplier to the big boys in Warsaw.

The 2,797 employees of SMA are clearly reaching for a larger piece of the \$300 billion global medical device market. Orthopedics, by the way, is only about 13% of that market (\$38 billion is our estimate of annual global orthopedic product sales). Historically, the top ten orthopedic manufacturers represented 76% of the orthopedic market with Symmetry operating as one of their many suppliers.

Symmetry's winning bid for Codman, while consistent with both recent strategic moves by SMA and management's stated diversification objectives, is nonetheless, a watershed event for this company. Wall Street may not yet be hearing it yet, but there is a clear and strong signal emanating from State Road in Warsaw that SMA is changing. Consider it a wake-up call. ♦