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Volcano Corp. Seen Luring Abbott With Activist Push: Real M&A

By Brooke Sutherland

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Nov. 13 (Bloomberg) -- Volcano Corp., a maker of diagnostic equipment to test for clogged arteries, may lure suitors from Abbott Laboratories to Medtronic Inc. as an activist investor tries to dress it up for a sale.

Engaged Capital LLC, led by former Relational Investors LLC partner Glenn Welling, disclosed a stake in Volcano last week that made it one of the company's 10 biggest shareholders. The firm said it's talking with management about ways to boost the shares of the \$1.1 billion company, which it sees as an eventual target for larger medical device makers. JMP Group Inc. said Abbott and Medtronic could be suitors.

Studies indicating cardiac stents are overused have curtailed their use, pressuring sales of Volcano's devices that help place them. Buyers still may covet the company's technology that assesses when stents are necessary and limits costs and side effects, said Jefferies Group LLC. While Engaged Capital said Volcano should wait to sell at a higher valuation, Eagle Asset Management Inc. said buyers may capitalize on its cheap stock. Volcano has a lower sales multiple than two-thirds of its North American peers, according to data compiled by Bloomberg.

Engaged Capital's involvement underscores "the long-term opportunities and how Volcano could be a nice acquisition target," Raj Denhoy, a New York-based analyst at Jefferies, said in a phone interview. "If you look at where health care is headed, in the United States and really around the world in terms of trying to improve outcomes and reducing the cost of therapy, this is right in that sweet spot."

Attractive Target

In its Nov. 4 filing disclosing a 5.1 percent stake in Volcano, Engaged Capital advocated for changes including repurchasing stock and tying management compensation more closely to increased shareholder value. Taking those steps and investing in existing products would boost the shares and may draw the attention of potential bidders, Welling, Engaged Capital's founder, said in a phone interview last week.

"Volcano is a very attractive acquisition candidate for the large medical device players within the cardiac space," Welling said. "We don't believe they should sell themselves today. Once the stock is more fairly valued, and once they've achieved some of the targets," it should pursue a sale.

Anton Nicholas, a spokesman for Engaged Capital who works at Integrated Corporate Relations Inc., declined to comment further. Engaged Capital, which was started in 2012, has also sought changes at drone-maker AeroVironment Inc.

Representatives for San Diego-based Volcano didn't respond to phone messages seeking comment on whether the company would consider a sale or had received interest from suitors.

Eyeing Arteries

Volcano has two primary technologies. One is intravascular ultrasound, which can be used by doctors to get images of the inside of blood vessels and ensure that cardiac stents -- metal- mesh tubes that are threaded

through the body to prop open clogged arteries -- are placed correctly. The other, fractional flow reserve, determines the severity of blockages and can help physicians determine when using a stent is appropriate.

With Volcano missing analysts' sales estimates in four of the last five quarters, the shares have dropped 25 percent in the last 12 months, even as the Russell 2000 Health Care Index surged 47 percent.

Results have been crimped in part because doctors are performing fewer procedures using stents amid increased scrutiny of their necessity, said Chris Pasquale, a Philadelphia-based analyst at JPMorgan Chase & Co. That's reduced demand for some of the company's technology, Pasquale said.

Good Prospects

While Volcano is projected by analysts to post its slowest revenue growth this year since it became publicly traded in 2006, the growth potential for its devices that can help doctors use stents more appropriately could attract acquirers, said Denhoy of Jefferies.

The technology "improves clinical outcomes and it reduces costs," Denhoy said. While Volcano's growth "might be somewhat challenging over the near term, there still are very good long-term prospects."

Medicare and Medicaid don't currently provide standalone reimbursement for Volcano's devices, though they do offer payments for placing stents, said Charley Jones of Barrington Research Associates Inc. in Chicago. That has doused some of the incentive to use Volcano's technology, he said. Ideally, that will change as the government realizes the benefits and tries to lessen its health-care spending burden, said Jones, who sees an eventual change in policy having an "exponential effect on growth."

New Products

New products -- including technology that can quickly assess coronary lesions, such as those in patients dealing with the deadliest form of heart attack -- will help to boost sales in the next few years, Jones said. Volcano now markets the technology in Japan and Europe and expects to sell it in the U.S. by the second half of 2014.

Abbott and Medtronic could be interested in buying Volcano to cut costs and boost revenue by marketing its products through existing sales networks, said Jose Haresco, a San Francisco-based analyst at JMP.

Scott Stoffel of Abbott Park, Illinois-based Abbott, said the company didn't have a comment when asked whether it would be interested in buying Volcano. Cindy Resman of Minneapolis-based Medtronic didn't respond to a phone message seeking comment.

While shareholders may complain about less than a 30 percent premium, or about \$26 a share, buyers could see Volcano's low stock price as an opportunity to snap up the company for a bargain, said Betsy Pecor, a fund manager at St. Petersburg, Florida-based Eagle Asset Management, which oversees about \$30 billion, including shares of Volcano.

'Right Opportunity'

Volcano trades at 2.8 times its \$393 million in revenue the last 12 months, a lower multiple than 65 percent of North American cardiovascular device makers valued at more than \$500 million, according to data compiled by Bloomberg.

Shareholders may want \$35 or more a share in a sale, said Jones of Barrington. Buyers may not be willing to offer that much until Volcano proves it can boost growth, said Jones and JMP's Haresco. If Engaged Capital is successful at accelerating growth, a deal may be more attractive for both management and suitors, Haresco said.

"They have always been viewed as an attractive target for a larger-cap company," said Haresco in a phone interview.

"They have a good core business. The products aren't commoditized. That's worth something to somebody."

--With assistance from Beth Jinks in New York and Peter Waldman in San Francisco. Editors: Beth Williams, Sarah Rabil