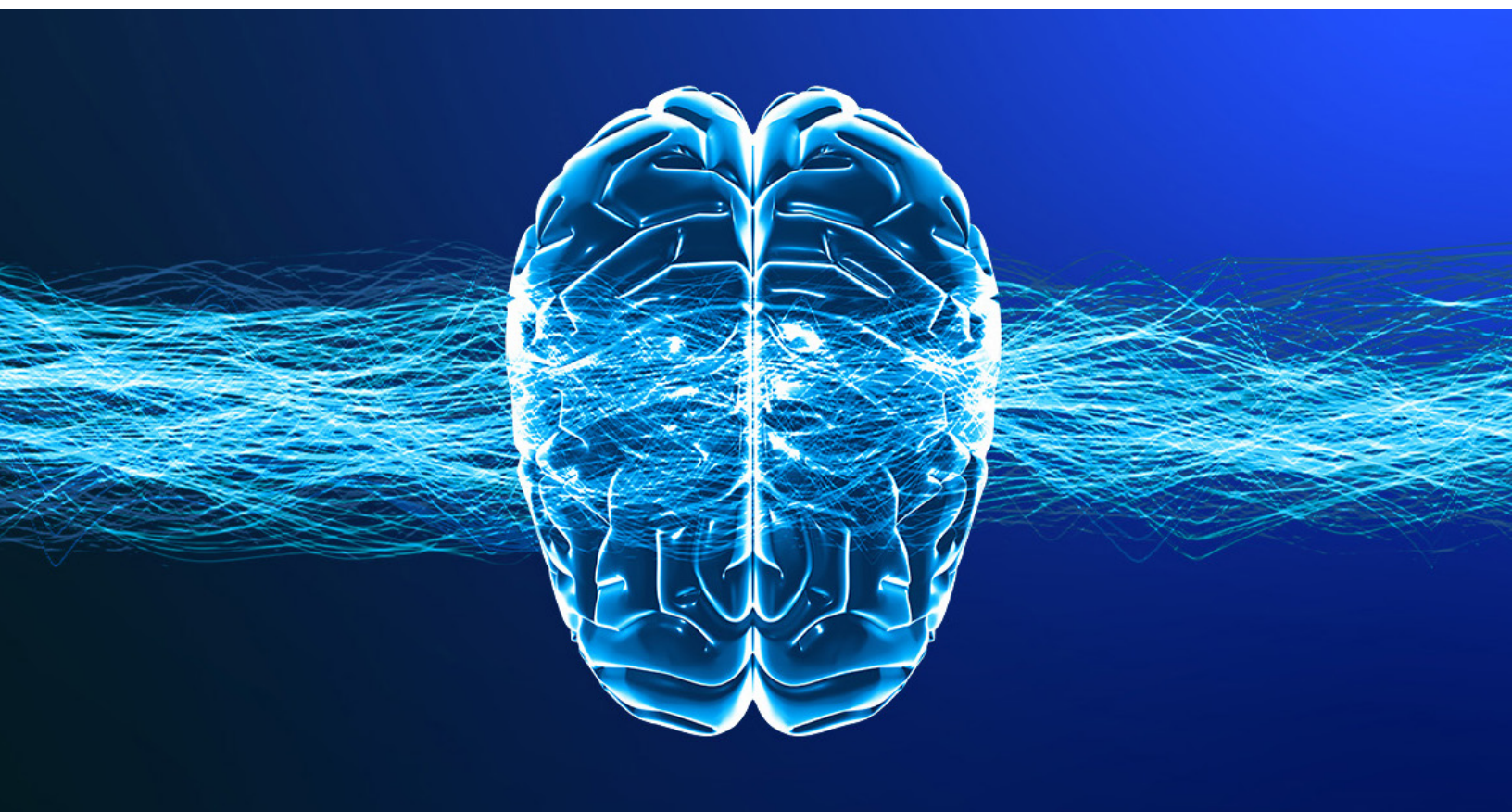


Life Sciences Practice

What to expect from medtech in 2024

Our medtech predictions for the year ahead were inspired by conversations with more than 200 industry leaders and informed by McKinsey's latest decade-ahead medtech report.

by Karsten Dalgaard, Gerti Pellumbi, Peter Pfeiffer, and Tommy Reid



The medtech industry posted an uneven year in 2023. Among the reasons for celebration were expectation-beating revenue growth, a record number of novel-product approvals, and a spate of divestitures that helped companies refocus on their core capabilities.

On the flip side, the growing popularity of glucagon-like peptide-1 (GLP-1) drugs for weight loss led investors to move away from many obesity-related-device stocks. Profitability did not meet investor expectations in an environment where margins increasingly became a key point of focus for valuations. And companies continued to struggle to perform consistently across geographies, especially outside the United States.

Indeed, 2023 marked the fourth consecutive challenging year for medtech, following a boom from 2012 to 2019.¹ Despite many advances, a value creation slowdown may force companies to make bold moves to reset their trajectories in response to investor skepticism and other macroeconomic headwinds.

Since the September 2023 publication of our comprehensive report *Medtech Pulse: Thriving in the next decade*, we have spoken to more than 200 medtech executives. In this article, we draw from the insights and questions that emerged from those conversations and offer seven predictions about the evolving industry landscape in the coming year.

1. Industry growth will likely stabilize at a higher level than the prepandemic average

Growth in medtech has accelerated since the COVID-19 pandemic, bringing with it higher expectations for medtech companies. The uptick in patient volumes due to the pandemic dampened in 2023. Other underlying growth factors driving patient volumes continue to persist, though, including demographic shifts because of aging populations and the availability of innovative technologies that address high unmet needs across such disease areas as diabetes, heart failure, and stroke. Growth is also being fueled by patients accessing new

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¹ S&P Capital IQ, S&P Global Market Intelligence, accessed on November 15, 2023.

and nontraditional sites of care, including alternative surgery centers (ASCs), medical offices, and outpatient settings.

Going into 2024, we expect overall medtech revenue growth to stabilize at 100 to 150 basis points above prepandemic rates (Exhibit 1). And as industry leaders look forward to the next five years, cardiovascular health, digital healthcare, and robotics are expected to be among the fastest-growing segments.²

These trends present several hurdles for medtech companies. First, as market growth rises, companies will find it more challenging to outperform expectations. Second, the widening growth rates between segments will require conglomerates to reallocate resources more thoughtfully. And third, the race to serve ASCs, medical offices, and outpatient settings will continue to intensify.

2. Investors will continue to seek profitable growth

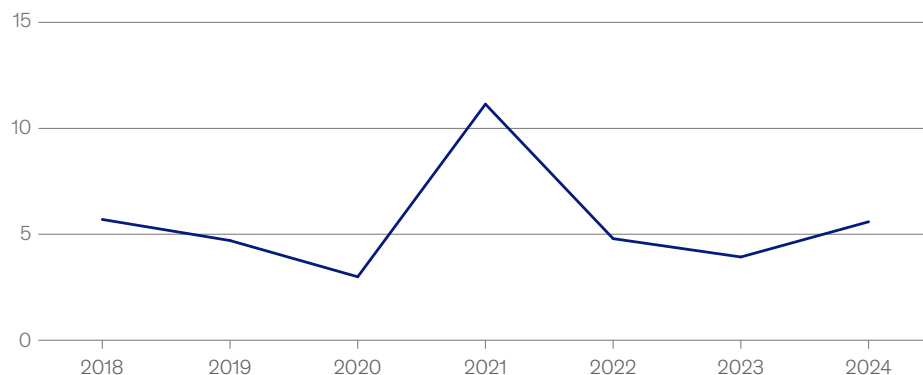
While sales growth remains chief in value creation, profitability and cash flow are increasingly coming into focus. The correlation between profit margin improvement and valuation has almost tripled since 2019.³ The top-quartile value creators in medtech improved their profitability in the past two years and are expected to continue expanding EBITA margins by at least 200 basis points over the next two years.

In conversations with medtech executives on profitability, we heard a common refrain: margin expansion will decrease in importance when interest rates decline. Historically, this line of thinking has been true. From 2014 to 2022, medtech valuations were inversely correlated with real treasury rates (Exhibit 2); as interest rates declined, investors focused more on revenue growth than on earnings growth, and valuations rose.

Exhibit 1

Medtech growth rates are starting to stabilize to prepandemic levels.

Top 20 global medtechs' organic revenue growth rate, year over year,¹ %



¹Growth rate is based on the weighted average of revenues of the top 20 global medtechs. Top 20 is defined by the largest publicly traded medtech companies globally by market cap, as of Nov 2023; 2024 projected organic growth rate is based on S&P Capital IQ analyst consensus for revenue. Source: S&P Capital IQ, S&P Global Market Intelligence, Nov 22, 2023

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² "Global medtech market analysis & projections (MAP)," Life Science Intelligence, accessed on December 4, 2023.

³ S&P Capital IQ, S&P Global Market Intelligence, accessed on November 15, 2023.

However, valuations have never been as disconnected from real rates as they have been in the past 18 months: even as interest rates rose dramatically, medtech valuations declined only modestly. As such, the expected decline

in interest rates in 2024 may not necessarily boost medtech valuations. Against this macrodynamic, investors will remain keenly focused on companies' ability to expand margins.

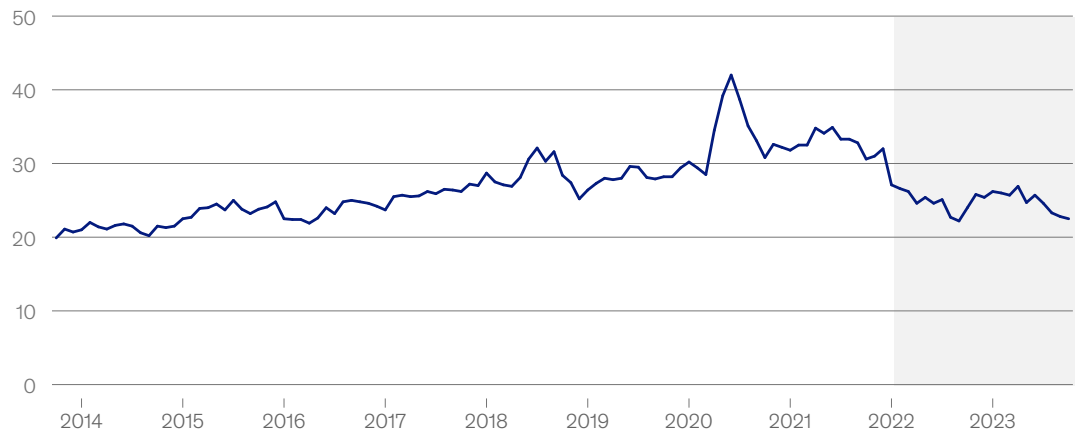
Exhibit 2

If treasury rates remain high, medtech multiples could decline further.

Real 10-year US treasury rate, %



Medtech next 12 months, P/E multiples¹



¹Median top 30 medtech companies, by market cap.
Source: S&P Capital IQ, S&P Global Market Intelligence, Dec 15, 2023

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3. The industry will deliver another banner year for innovation

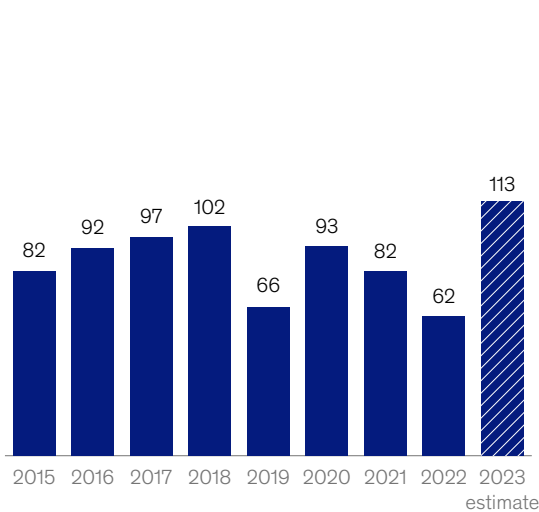
In 2023, the US Food and Drug Administration (FDA) approved more novel medical technologies than it has in any single year ever before (Exhibit 3). Several factors contributed: approvals of AI and machine-learning-enabled medtech products reached an all-time high; miniaturization and improved visualization continued to drive approvals in cardiovascular and urology segments, among others; and digitally enabled categories, such as neuromodulation and robotics, continued to grow steadily. Also, waiting times for FDA reviews receded by almost 15 percent from 2020 to 2022.⁴

Based on our conversations with medtech executives, we expect the pace of innovation in 2024 to exceed 2020 to 2022 levels, with cardiovascular, digital-health-device, and neuromodulation segments gaining momentum. Advanced imaging, microelectronics, miniaturization, and new treatment modalities, such as renal denervation, are spurring innovation in underserved disease areas. These exciting advances can fuel the next wave of growth and improvements in patients' quality of life. The pace of innovation also means more competition for medtech companies. Increasingly, it's the big, novel innovations that will drive commercial relevance and growth—incrementalism won't be enough.

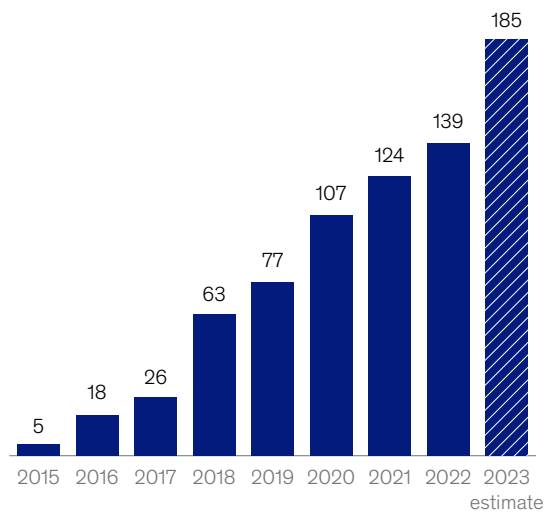
Exhibit 3

The innovation pipeline is opening, with medtech generating the industry's most novel approvals ever.

Novel FDA approvals,¹ number



All FDA approvals, AI/ML-enabled,² number



Note: Projected 2023 approvals.

¹US Food and Drug Administration approvals include original premarket approvals (PMA), panel track PMA, and 510(k) De Novo approvals.

²The FDA publishes lists of approved AI/machine learning-enabled medical devices primarily based on information provided in the summary descriptions of the submitter's marketing authorization document. The 2023 estimates are annualizations via linear regression.

Source: Evaluate Medtech; FDA database

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⁴ "2023 device approvals," US Food and Drug Administration, updated on December 22, 2023.

4. Performance across geographies will continue to be lumpy

In 2024, we project that China, Japan, and the United States will contribute two-thirds of near-term industry growth in medtech. Across more established markets, such as Japan and the United States, growth continues to be driven by innovation and the adoption of innovative technologies. In the United States, commercial execution and innovation will be the hallmarks of growth.

The market in Japan will likely behave similarly, though CFOs and finance leaders there will need to be thoughtful about managing currency risk (for example, through hedging strategies). Domestic and international companies are facing foreign-exchange challenges in Japan, making the US market even more critical to overall industry growth.

Growth in Europe will likely slow after a year in which price increases saw a step-up in the underlying growth rate. Medtech companies that thrive in the European market will tap fresh solutions to help providers manage workforce shortages and improve health economics through reduced readmissions and shorter hospital stays.

Elsewhere, medtech leaders are tackling difficult strategic choices. China has delivered tremendous growth over the past decade. However, increasing complexity, local competition, and volume-based procurement have posed challenges for multinational corporations. India will begin to make a bigger splash, thanks to favorable governmental-policy changes, increased investment flow, a maturing tech ecosystem, and the emergence of growing local businesses that are increasing provider access to technology and training.

5. Leaders in AI adoption will start to see benefits of scale

The underlying technologies of generative AI (gen AI)—namely, foundational models—have a [long history in life sciences](#) and medtech. Foundational

models representing complex structures have already been used in many insight-generating tasks, particularly in product development. For example, digital-twin technologies (virtual representations of physical medtech devices paired with deep-learning models) have been used to validate alternative, and more effective, device designs. Most of the gen-AI-related activity in medtech to date has focused on device enablement, functionality, and R&D, with untapped opportunities in commercial, supply chain, and other business functions.

Medtech companies that adopt gen AI are starting to gain productivity benefits, starting with low-hanging fruit such as “copilots” for workers in HR, IT, finance, and legal roles. Companies are beginning to explore the impact of gen AI on commercial and operational roles. Because of regulatory requirements, the deep integration of AI in medical products and services remains years away. However, some companies will start integrating gen AI into their products and software, such as by leveraging voice prompts. New capabilities and talent will be needed to capture the business value fully. Given the rapid pace of innovation, early adopters are likely to have an advantage over the competition.

6. M&A deal volumes will likely remain stable, with a continued balance of growth and at-scale transactions

Medtech M&A slowed in 2023 amid earnings challenges, macroeconomic uncertainty, and rising interest rates. Meanwhile, large buyers set a precedent of paying premiums at or above 52-week highs.⁵ Many of these buyers were in pursuit of meeting rising growth expectations and unlocking margin expansion.

While growth-focused tuck-in deals will remain critical to value creation, they are not always available to companies at attractive valuations. Another tool that companies are increasingly exploring is at-scale transactions. Larger acquisitions can offer operating leverage, which can help medtech

⁵ LSEG Data & Analytics, London Stock Exchange, accessed on August 28, 2023; S&P Capital IQ, S&P Global Market Intelligence, accessed on August 28, 2023.

companies improve margins that currently sit near 2018 levels (Exhibit 4); they can also help companies in lower-growth markets improve their commercial presence with more end-to-end solutions that help care teams streamline operations and focus on patient care.

We anticipate that the volume of M&A activity will remain low but that the deals that are executed will show more balance across deal sizes. Medtech companies continue to have “dry powder” that accumulated during the COVID-19 pandemic, with approximately \$55 billion of cash and cash equivalents.⁶ However, high-growth, at-scale, and

profitable targets remain scarce. Interested acquirers will need to act quickly, given the scarcity of options.

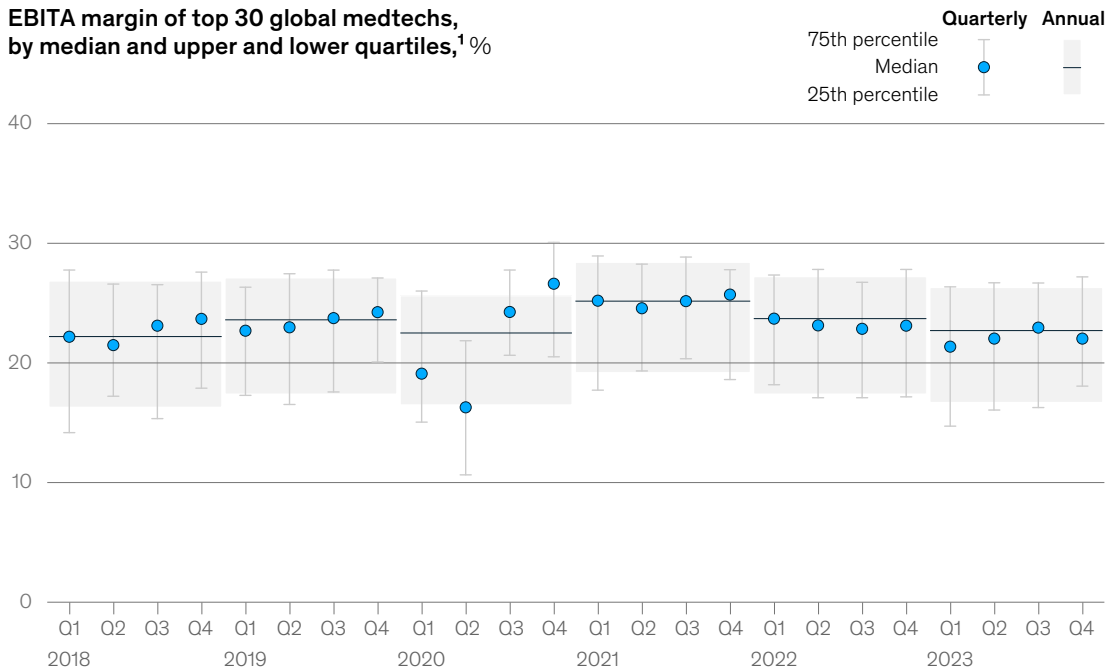
7. Penetration of GLP-1 drugs will continue but is unlikely to have meaningful impact on medtech growth

GLP-1 therapies have been deployed to treat type 2 diabetes since 2005. Recently, their indications have expanded to obesity, and emerging data suggest that these drugs could help even more patients, including those with cardiovascular or chronic kidney disease. The market has responded, with shares

Exhibit 4

Profit margins for global medtechs have not improved since 2018 and remain lower than they were in 2021.

EBITA margin of top 30 global medtechs, by median and upper and lower quartiles,¹%



¹Top 30 global medtechs, based on 2022 sales with data available from 2018 to the current Q4 estimate for 2023. Source: S&P Capital IQ, S&P Global Market Intelligence, Nov 15, 2023

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⁶ Ibid.

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of GLP-1 drug manufacturers rising 26 percent in two months after trial readouts.⁷ At the same time, medtech stocks, particularly those that are obesity related and in adjacent categories (such as cardiovascular health, diabetes, orthopedics, sleep apnea, and surgery), dipped 17 percent amid concerns that GLP-1 therapy adoption will dramatically reduce the need for device-enabled diagnostics and interventions.⁸

Indeed, GLP-1 drugs may meaningfully aid many patients, but they will likely have minimal effect on most medtech markets. Long-term use of GLP-1 therapy will depend on patient adherence to the prescription, payer coverage, and prescription rates. Our analysis across scenarios suggests that, for most indications across medtech sectors, low-single-digit percentages of patient populations will

become long-term users of the therapy. In the meantime, GLP-1 drugs are much on the mind of analysts, executives, investors, and patients, so medtech companies will need proactive, fact-based narratives to describe the potential business impacts.

While reflecting on the past year's growth and challenges, industry leaders have reason to be energized by the promise of 2024. The new year will bring innovations that improve more lives, opportunities to create value, and fresh approaches that adapt to market-shaping trends. Although obstacles remain, the medtech industry is poised to continue to deliver benefits to all its stakeholders.

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⁷ S&P Capital IQ, S&P Global Market Intelligence, accessed on October 13, 2023.

⁸ Ibid.