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This giant medical products company is unknown no more

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REUTERS/Newscom

Medline CEO Charles Mills speaks at a news conference in the Rose Garden of the White House in March. Mills says “a lot of customers are asking for way, way more product than there’s possible supply.”

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Medline Industries attracted little public attention for decades as it grew to become the largest privately owned supplier of medical products.

It took COVID-19 just a couple of months to drag the $14 billion-revenue company into the global spotlight as a critical source of desperately needed personal protective equipment for health care workers battling the pandemic. But the attention hasn't always been flattering, and surging demand for basics like surgical gloves and face masks hasn't been the windfall it might appear to be.

"If anything, it has slowed down our growth," CEO Charlie Mills says, explaining that the outbreak hurts demand in Medline's larger product lines while boosting sales in a relatively small corner of its business.

Pressure to ramp up production of low-margin products that account for less than 5 percent of revenue isn't the only challenge for Northfield-based Medline. COVID-19 also has broader implications for the business model that has generated consistent double-digit annual growth rates for the company founded by Mills' great-grandfather 110 years ago.

Medline's growth strategy focuses on sales of highly profitable surgical products, which dropped sharply as hospitals besieged by coronavirus patients canceled elective procedures. Representing about 40 percent of revenue, surgical product sales "are probably down roughly half," Mills says.

After the pandemic eases, Medline could face calls to reduce its reliance on Chinese producers for personal protective equipment, or PPE, and to keep even larger inventories on hand to ensure hospitals don't run out of essential equipment during the next crisis. Both moves could boost operating costs.

Meanwhile, Medline is under scrutiny from lawmakers for its part in Project Airbridge, in which the federal government aims to expedite the shipment of critical supplies from factories overseas. While the government covers the cost to fly supplies into the U.S., Medline and other players in turn have to sell 50 percent of PPE to customers in virus hot spots, like Illinois and New York.

CRITICISM

The program has been criticized for a lack of transparency over matters such as which customers are getting what and how much they're paying. It also has come under fire for pitting states against each other, as well as against private organizations and other countries. Sens. Elizabeth Warren and Richard Blumenthal have called on Project Airbridge companies to explain how supplies are priced and distributed amid reports of equipment "being seized by the government, price gouging and political favoritism."

Mills says "a lot of customers are asking for way, way more product than there's possible supply, and so FEMA has tried to help direct that some. We're getting a lot more scrutiny because of that than we normally have had."

Asked whether Project Airbridge has affected Medline's relationships with existing customers that aren't getting as much PPE as they want, Mills says, "We're working hard to supply our accounts. We're just trying to do our part. If FEMA asks us to do something, we'll do our best to do it."

As a result of bottlenecks earlier this year as COVID-19 spread across Wuhan, medical products companies that rely heavily on low-cost Chinese manufacturers likely will need to diversify supply chains into other areas where labor might be more expensive.

"We'll see what the government mandates," Mills says.

Whether the federal government will provide financial incentives for those companies to diversify their PPE sources "is a big question mark at the moment," says David Ding, director of the Healthcare Analytics & Intelligence program at Rutgers Business School. "Obviously (the companies) are going to incur much higher costs. Would they be able to raise the price so that we, as end users, would pay more out of pocket? That's a very classic debate."

Costs already are rising for Medline and other distributors handling large PPE volumes from Project Airbridge. Morningstar analyst Soo Romanoff points to special bonus pay for line workers, higher cleaning costs and a likely increase in unpaid invoices when all is said and done.

"So it's been great for revenues maybe in March, but in April I think they're going to see all these expenses come in," Romanoff says.

Another cost is the impact of COVID-19 on demand for surgical kits, one of Medline's primary growth drivers. The kits are customized arrays of sterilized equipment needed for general use or to perform specific procedures. The budding business brought in $1.2 billion last year, nearly 10 percent of sales.

Global sales of surgical kits are expected to reach $38 billion in five years, up from $19 billion in 2017, according to one pre-COVID estimate. However, amid the pandemic, demand for the kits is down about 50 percent, Mills says, noting that he has around 8,000 workers dedicated to assembling the packs. The company so far has avoided furloughs by reassigning employees to other jobs within the organization, with production and warehousing workers getting higher wages as a result of the pandemic.

Mills predicts surgical kit sales will bounce back as hospitals resume elective procedures. In the meantime, Medline has slowed down production of surgical products to focus on supplying PPE. For example, the company stopped making povidone-iodine, an antiseptic used during surgical procedures, at a 300,000-square-foot Hartland, Wis., plant that's now producing hand sanitizer.

STRONG NETWORK

Sources say that flexibility is one reason Medline is better positioned than competitors to weather the pandemic. The company is both a manufacturer and a distributor. Products made in-house are Medline's most profitable—accounting for more than half its sales but only about a tenth of the 550,000 products it offers.

"Medline is involved in each and every piece of the whole supply chain, starting from the very beginning of the production process," Ding says. "So they have a much better understanding and a stronger network in terms of getting those materials from the right partners"—and maybe even better prices.

In addition to being less exposed to the dental industry, where patient volumes have plummeted, Medline also has benefited from keeping more inventory on hand—something sources say it has more flexibility to do than its publicly traded competitors.

The company traditionally stocks three months of Medline products and a month and a half of other brands, Mills says, noting that the reserves have helped shield customers, despite PPE shortages.

Following COVID-19, hospital chains that can afford to likely will abandon just-in-time inventory strategies, which could be a boon to Medline and others, Romanoff says.

For now, Mills is focused on getting customers the products they need to combat COVID-19. Still, this could be the first time in 20 years that Medline doesn't post a double-digit sales increase.

"If this stays like it is all year, then, sure, we'll have a flat year in revenue and probably a down year in profits, and that will be OK," Mills says. "It's not forever, but you have to change to what the environment is."

Inline Play

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