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Healthcare

INDUSTRY OVERVIEW



Healthcare Introduction

UNDERSTANDING THE BASICS

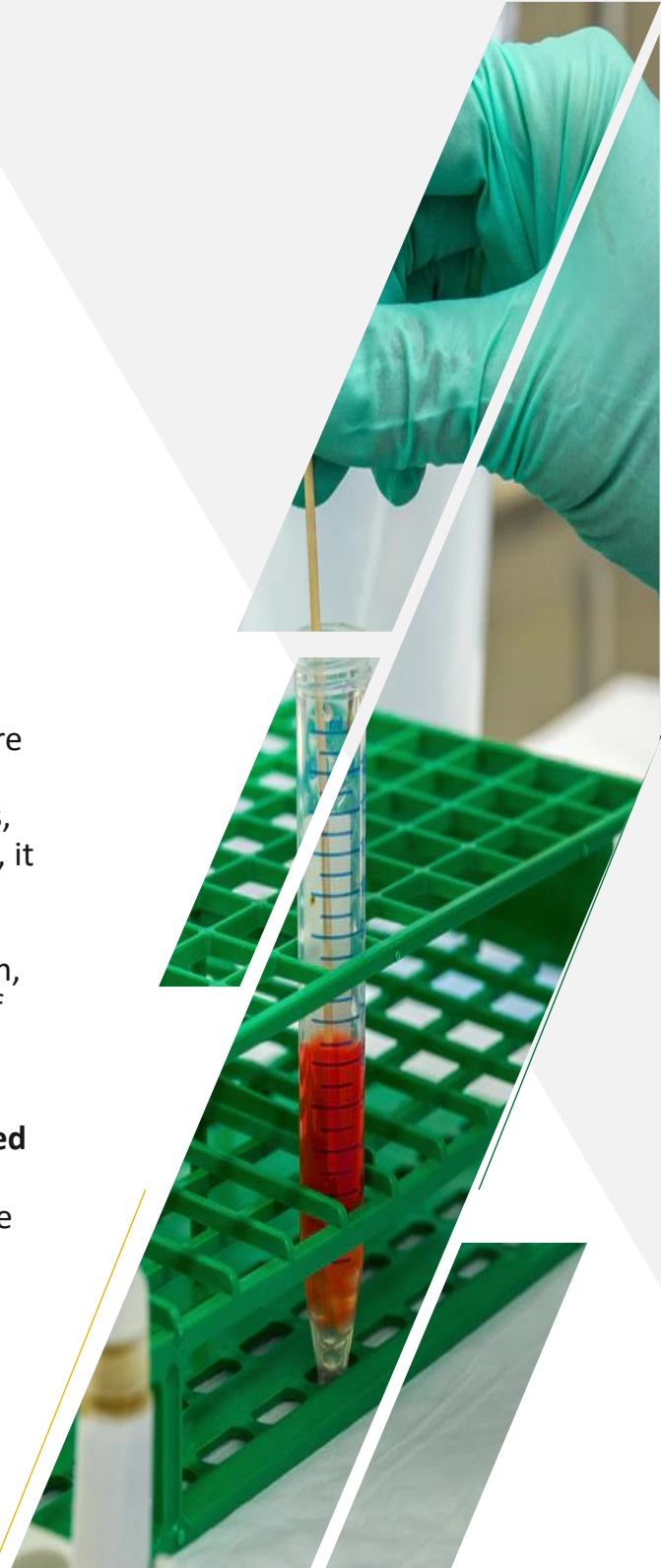
The healthcare industry is one of the world's largest and fastest-growing industries. A well-functioning healthcare system consists of a good financing mechanism, a well-trained and adequately paid workforce, reliable information upon which decisions and policies are made, and well-maintained facilities and logistics to deliver quality medicines and technologies, according to the World Health Organization. This industry can be separated into two sub-sectors:

1. Healthcare Equipment and Services

- This sector consists of companies that provide equipment and supplies which are used by physicians and other medical personnel to help aid in patient diagnosis, monitoring, and treatment. Furthermore, it also involves certain services that are responsible for the maintenance or improvement of health via the prevention, diagnosis, treatment, recovery, or cure of disease, illness, injury, and other physical and mental impairments in people.

2. Pharmaceuticals, Biotechnology, and Related Life Sciences

- In this sector, companies primarily engage in the research, development, manufacturing, and/or marketing of products based on genetic analysis and genetic engineering. This includes companies specializing in protein-based therapeutics to treat human diseases. These companies usually engage in the research, development or production of pharmaceuticals.



Healthcare Equipment and Services

SUB-SECTOR ANALYSIS

The two main product categories of this sub-sector are all highly competitive due to an aging population creating greater demand for the basic need products and health care equipment used in research development. As a result, creating a sustainable competitive advantage is difficult due to the commoditization of this sub-sector.

Key Drivers of this Sub-Sector

- Growing aging population that continues to increase the usage of this sub-sector due to their susceptibility to disease.
- Technological and Medical innovations drive this sub-sector's customer demand for their products and services.

Market Sensitivity

- The healthcare equipment and services sector creates very low-price elasticity of demand. As a result, consumers are not as sensitive to market prices and in most cases depend on these products no matter pricing.
- The sensitivity based on macro-economic factors is relatively low for this sector due to its defensive position through its necessity. As a result, it is much more accurate to assess the sector's sensitivity to consumer preferences and trends.



Pharmaceuticals, Biotechnology and Related Life Sciences

SUB-SECTOR ANALYSIS

The sub-sector can be split into three major groups: pharmaceuticals, biotechnology, and related life sciences. Consequently, this highly diverse sector has industries with various parts in the product life cycle and competitive outlooks.

Key Drivers of this Sub-Sector

- Continuous innovation of product mix and need for creative solutions to solve some of the toughest modern-day medical challenges.
- Aging population that requires more solutions to diseases, illnesses, and injuries.
- Creating more accessible and affordable products to reach a greater target audience.

Market Sensitivity

- The business cycle for this sub-sector is non-cyclical. These firms are a necessity, which are positioned quite defensively due to the constant need for medical innovation and drug usage.
- This sector is known for having government and regulation volatility. This leads to some uncertainty in regard to industry performance in any given year.

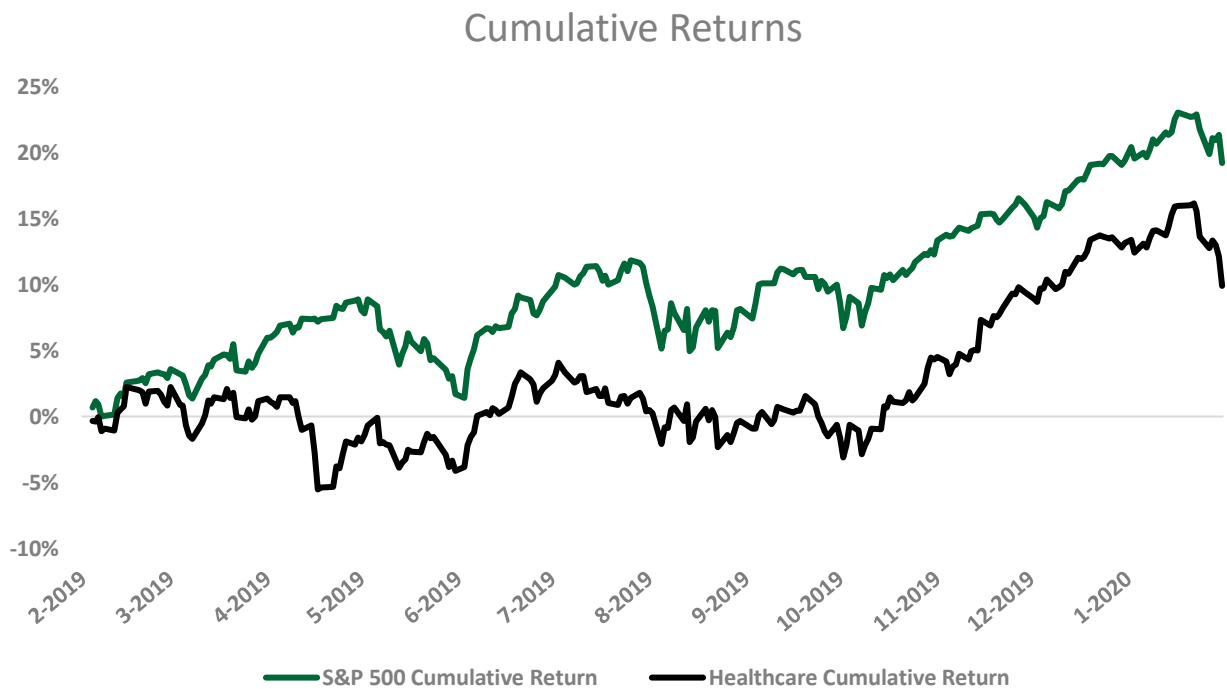


Sector Analysis

VALUATION OF HEALTHCARE

The healthcare industry had a total market capitalization \$6.15T, which accounted for 14.09% of the total market share in the S&P 500. Healthcare continues to be one of the healthiest sectors in 2019 and had a relatively strong performance, while the whole market showed a decline in earnings. The overall performance of the industry is represented in Figure 1 below. Compared with other sectors within the index, healthcare in the US underperformed the S&P 500 market index at an annualized return of 18.78% versus 27.20%. However, healthcare has maintained positive and stable returns over time and outperforms the market on an expanded time horizon. The sub-sector that leads in the healthcare sector are Healthcare Technologies because of the innovation trends within health care equipment and supplies and life sciences tools and services.

Figure 1: Cumulative Returns of the S&P 500 and the S&P 500 Healthcare Indices



Medical Equipment and Services Companies

HIGH-LEVEL ANALYSIS

- While private home service providers and retirement homes have capitalized on the lack of supply that the government is currently providing, the equipment vertical has an opportunity to capitalize on a trade gap. Canada alone had a trade gap consisting of \$3.1B exports and \$8.6B imports in 2016.
- With growing demand for healthcare professionals bolstered by an aging population with an increased focus on health, healthcare staffing agencies are expected to grow by 3.3% annually from 2016 to 2022.
- In addition to increased staffing, health care facilities are the most important factor for growth. The two largest areas of healthcare spending in the US are hospital care (\$1.1T in 2017) and physician/clinical services (\$694B in 2017).

Figure 2: EV/EBITDA Ratios of the Top 5 Medical Equipment and Services Companies by Market Cap (Descending)

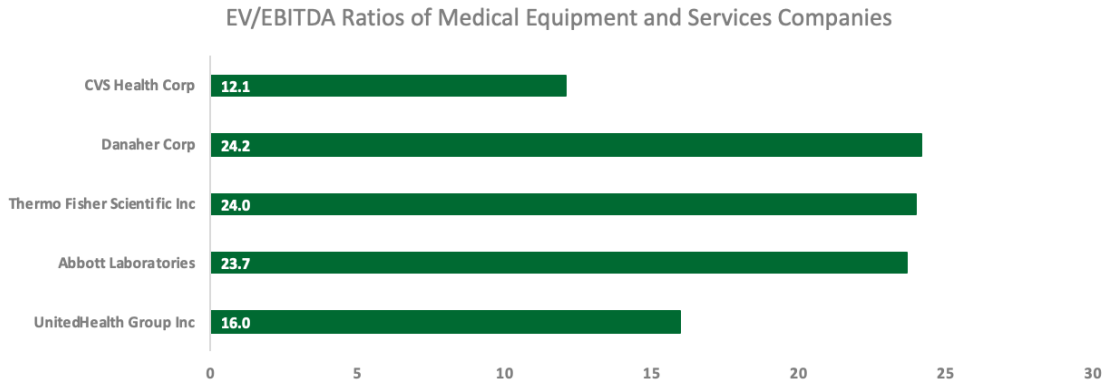
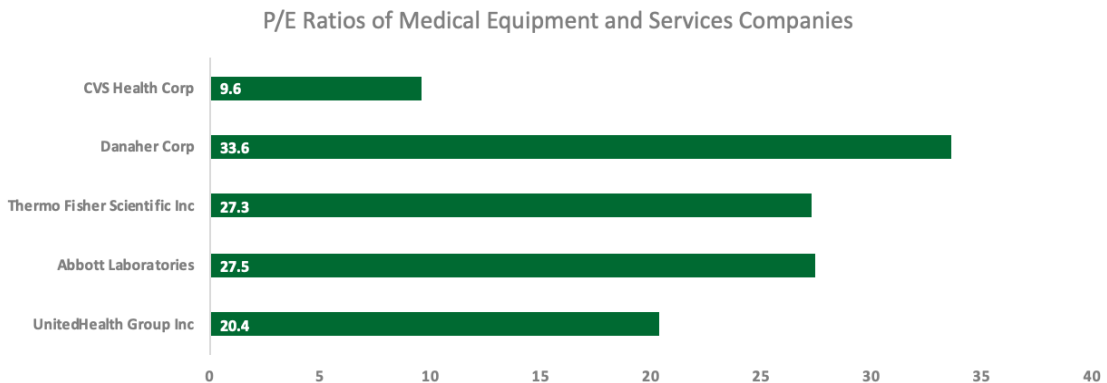


Figure 3: P/E Ratios of the Top 5 Medical Equipment and Services Companies by Market Cap (Descending)



Pharmaceuticals, Biotech, and Related Life Sciences Companies

HIGH-LEVEL ANALYSIS

- If Canadian market regulators were to relax constraints on producers and exports the sector could be led by Cannabis products granted to new markets for exportation. The TSX Health Care Capped Index (TSX: TTHC) witnessed a 16% decline in value in 2019, as 5 of the 10 constituents were Cannabis equities that weighed the index down.
- Biotech has seen the federal government financially back nearly 80% of the industry. In 2017, 9% of Canadian biotech companies reported revenues of greater than \$10 million, and that number is expected to increase to 40% by 2021. Biotech is slated to slow down in the US with expected growth rates of -9.7% and -2.1% in 2019 and 2020.

Figure 4: EV/EBITDA Ratios of the Top 5 Pharmaceuticals, Biotech, and Related Life Sciences Companies by Market Cap (Descending)

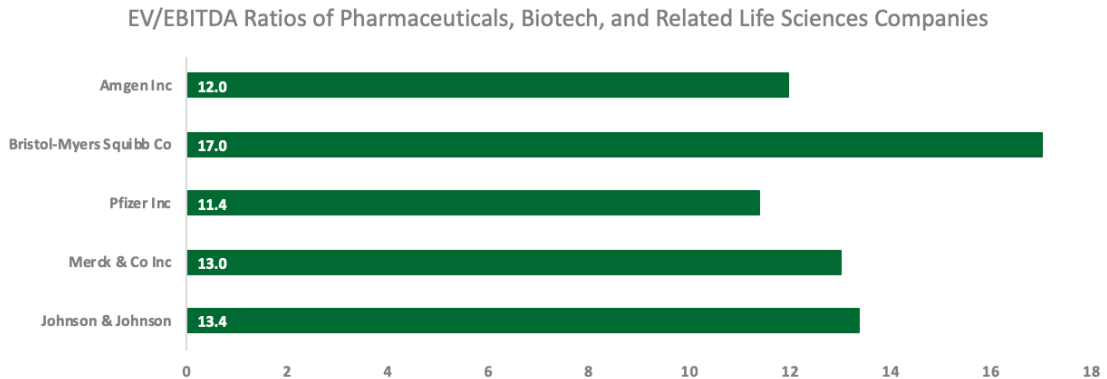
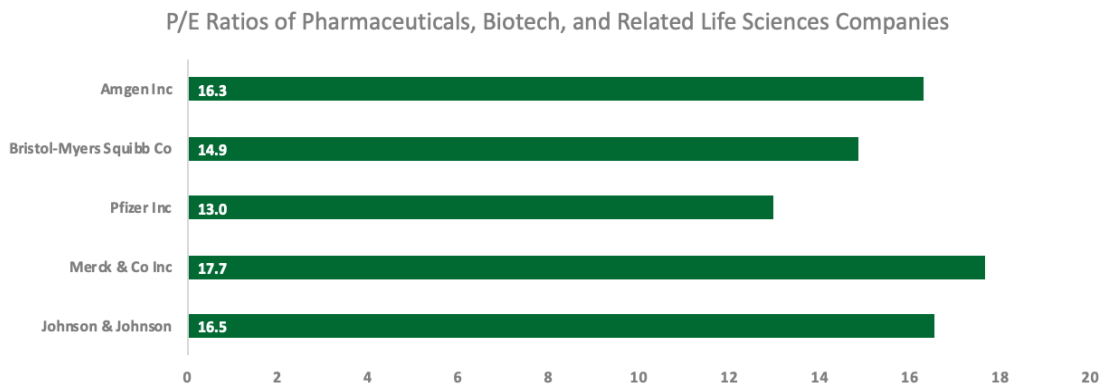


Figure 5: P/E Ratios of the Top 5 Pharmaceuticals, Biotech, and Related Life Sciences Companies by Market Cap (Descending)



Industry Trends

HEALTHCARE

Large-Scale M&A

- M&A activity within the healthcare sector has been robust with M&A volume increasing by 14.4 percent from 2017 to 2018, according to one PwC report. Vertical integration seems to be a rationale for many large-scale healthcare M&A deals, as we can see that companies are merging both up and down the supply chain, including PBMs, providers, and pharmacies.

Clinical / Patient Data Management

- As the trend of shifting from fee-for-service to value-based care continues, it has raised the need from providers to harness the power of data to deliver the best services to consumers and enhance efficiencies. Clinical and patient data management, interoperability, and security will be essential for a successful transition towards alternative payment and delivery models.

Prescription Drug Pricing and Medication Adherence

- Increased activity in drug pricing and medication adherence expresses the need for improvement of these areas from stakeholders. Medication adherence in the pharmaceutical space costs the US healthcare system \$300B annually which leads it to be an area of concern. Recently, there has been legislative activity revolving around drug pricing and coverage, as seen by the US House passing H.R. 987.



Industry Trends

HEALTHCARE

Horizontal Integration (e.g., Health System Mergers)

- This involves the integration of health systems with more and more specific medical components. This is likely to continue due to its potential to strengthen service lines or mitigate volume pressure and high costs.

Consumer- and Patient-Centricity

- This remains a key element of most health services companies' strategies, particularly given the increased focus on social determinants of health and proposed rules calling for greater patient data access and interoperability. Companies are likely to pursue deals and alliances to add assets that further these goals.

Aging Population and Rising Life Expectancy

- Finally, there is a mismatch of demand and supply specific to some types of healthcare providers. As life expectancies continue to rise, it is estimated that 70% of 65-year-olds are expected to need long-term care at some point in their lives.

Short-Term Healthcare

FUTURE OUTLOOK

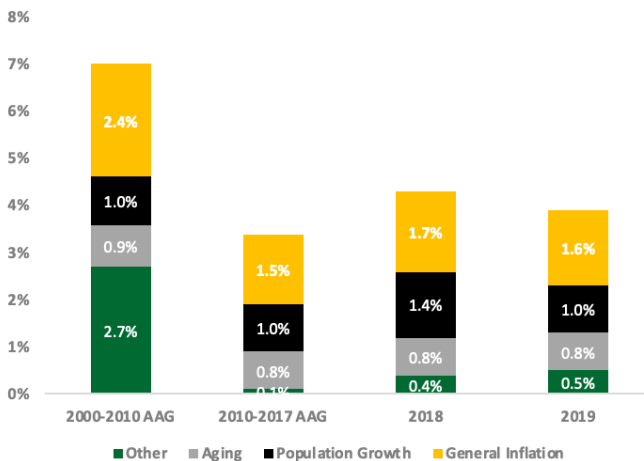
2020 Expectations

Healthcare spending is likely to increase due to the rising number of aging populations, but also pharmaceutical costs. Investments from authoritative bodies to address issues from underfunded healthcare services are expected for the rest of 2020. Additionally, price control and regulation are something that may affect company performance, specifically in Canada and the US.

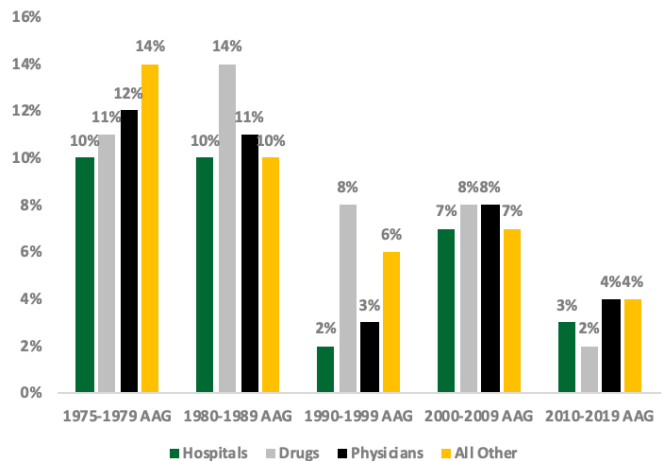
Impact on Healthcare Market

The healthcare sector is expected to be defined by continued efforts to contain rising costs of care while maximizing efficiency amid heightened demand from an aging population. Revenue growth is expected to be influenced by the performance of the overall economy, the growing US population, unemployment, and federal funding for programs such as Medicare and Medicaid. Increased funding for elderly populations covered by Medicaid, combined with rising total health expenditure, is expected to provide steady funding for sector services. As a result, revenue for the healthcare and social assistance sector is forecasted to grow at an annualized rate of 1.7% to \$3.1 trillion over the five years to 2024.

Cost Drivers of Average Annual Growth in Public Sector Health Spending



Average Annual Growth in Total Health Expenditure



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