

Outlook 2023

Healthcare



SIGNET

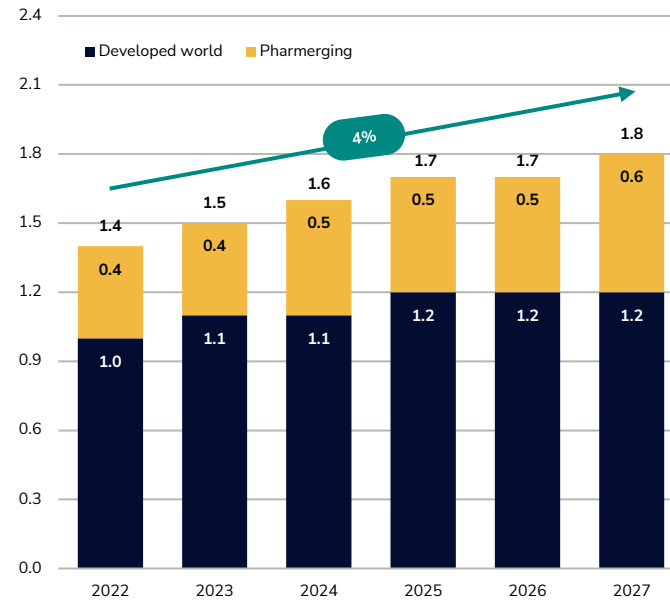
Health care Pharma

Stable and cash generative

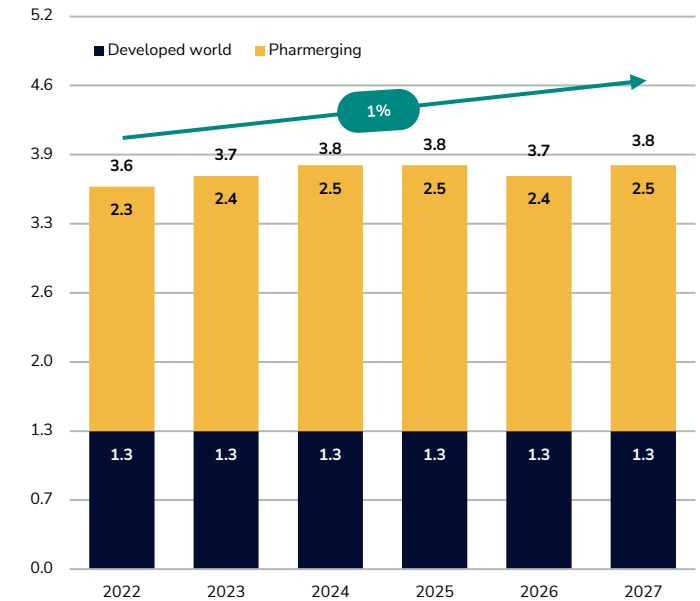
We favor investing in companies with lower USD-exposure (assuming peaking USD strength in 2023), substantial cash balances (to execute bolt-on acquisitions) and consistently high ROIC.

- 2022 overview.** Pharmaceuticals' market value continued to grow at a stable pace (fig. 1) fueled by an increase in the use of existing medicines (fig. 2) and drug discovery.
- Drug prices and projected spending composition.** Drug prices are forecast to grow at a modest pace in 2023: 2.7% for contract products and 3.6% for non-contract products. Oncology is projected to account for 22.8% of total drug spending, with oncology- and dermatology-related drugs to lead price appreciation (fig. 3). By 2025, pharma spending on new brands is expected to outpace income declines arising from loss of exclusivity (fig. 4).
- Regulatory shifts.** The major upcoming regulatory change is the Drug Supply Chain Security Act, due to be enacted in Nov'23. This will require pharmaceutical companies to provide stipulated data alongside product shipments to trading partners, or face shipping constraints and/or fines. Moreover, US lawmakers are considering price caps for insulin and several other drugs.
- Impact of the strong USD.** Most global, non-US providers (including Sanofi: +7.6% translational effect on sales for 9M, GSK, +9.0% and Novo Nordisk, +10.0%) have benefited from the strong USD. Conversely, both US-incorporated Global Pharma providers and global players with a substantially USD-denominated cost base (such as Johnson & Johnson and Roche) have suffered.
- Mergers and acquisitions.** The strong financial results registered by biopharma companies in 2022 contributed to substantial M&A activity. We expect many big pharma firms to accumulate substantial cash balances in the next three years, facilitating deals to augment their pipelines in 2023 and beyond. (At the end of 3Q22, Pfizer, Johnson & Johnson and AbbVie had the highest cash balances.)

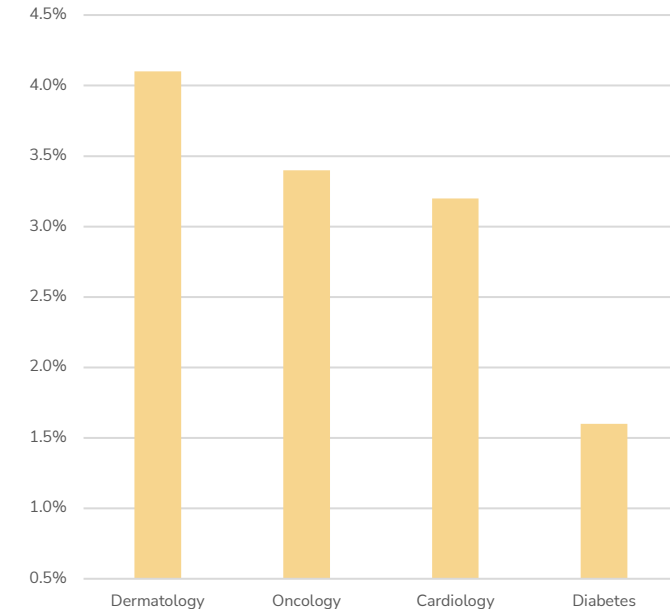
1. Projected Global Pharma Market Value, \$tr



2. Projected Use of Medicines, mn daily doses



3. Pharmacy Price Growth by Disease in 2023, %



4. Global Pharma Spending by 2025, \$bn

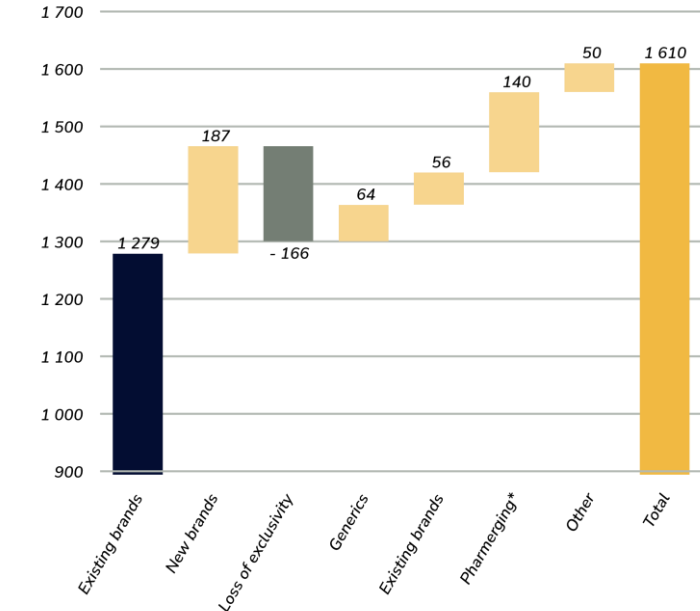
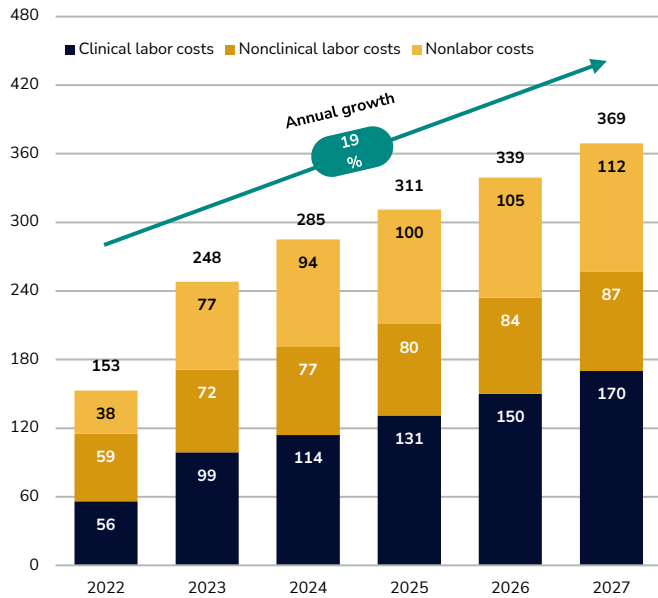


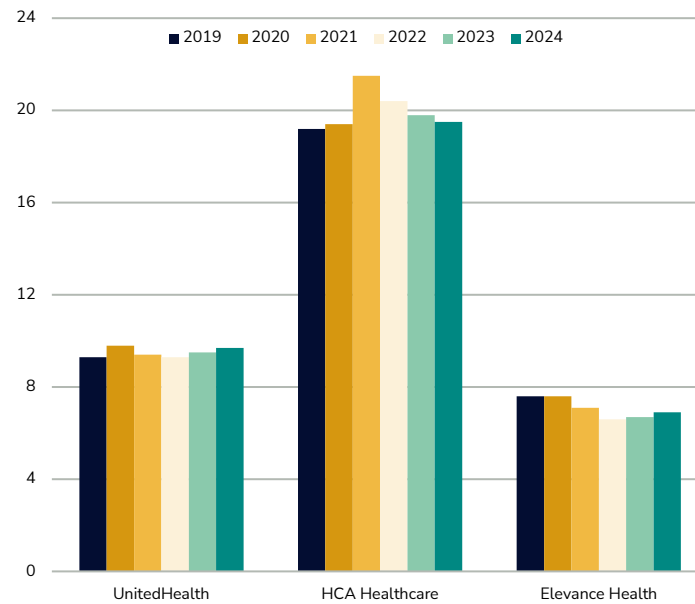
Chart sources: (1, 2) IQVIA. (3) Vizient. (4) Center for Medicare and Medicaid Services, IQVIA. Note: Pharmerging countries are countries with a low position on the pharmaceutical market, but growing at higher pace

Health care Services

1. Projected US Healthcare Costs, \$bn



2. EBITDA Margins of Selected US Players, %

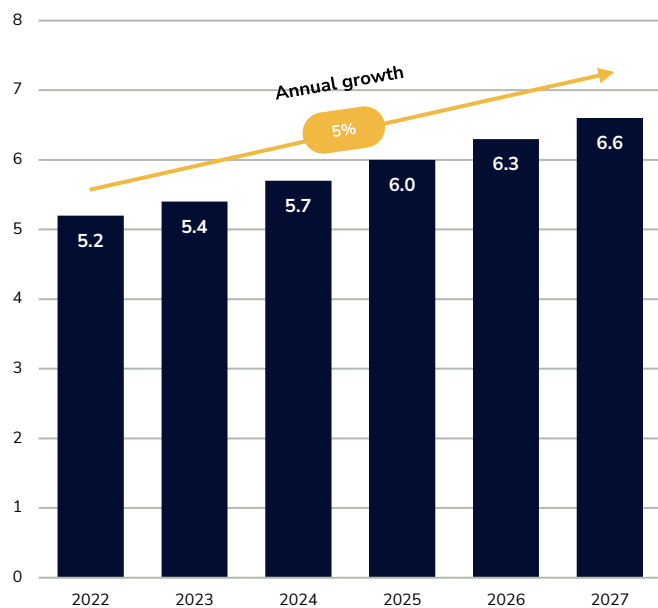


Structurally growing

We like companies that demonstrate moderation in wage growth, exhibit high-and-growing ROIC and benefit from emerging new trends (such as the growing adoption of Medicare Advantage).

- 2022 overview.** Healthcare services faced multiple challenges, including rising costs (labor- and drug-related costs +37% vs. 2019, supply costs +21%), coverage shifts (about 15mm Medicaid enrollees may lose coverage after the COVID-19) and regulatory changes.
- Costs and margins forecast for 2023.** Total healthcare costs are projected to grow by 62% in 2023 Y/Y (fig. 1), driven by cost inflation, clinical labor wage growth and rising interest rates. Margin dynamics in 2023 (fig. 2) will differ for the various providers, with HCA experiencing minor deceleration, while others experience growth.
- Labor force forecast for 2023.** Contraction in the labor force will lead to a gap of 190k-440k registered nurses and 48k-75k doctors (10-20% and 6-10% of the workforce, respectively) driving Y/Y labor cost growth of 5-10% in 2023-2024.
- Regulatory shifts.** Since Oct'22, healthcare providers have been required to implement the 21st Century Cures Act. Starting from 2023, there are substantial changes in County Plan Models under the COHS plan (which has a moderately negative impact on multi-plan providers). We expect the COVID-19 public health emergency and national emergency to conclude in 2023.
- Shifts in demand.** Rapid growth in the over-65 population, increased adoption of Medicare Advantage (44% in 2021, forecast to grow to 52% by 2030 amongst the Medicare population) and improved profitability of managed Medicaid (due to more coordinated and integrated care) will increase demand for managed services. Total national health executive spending in 2023 (fig. 3) will be driven primarily by hospital care (fig. 4).
- Mergers and Acquisitions.** Despite inflationary pressures, existing players plans to accelerate M&A activity in 2023. New players are also investing in this area: Amazon plans to close their acquisition of One Medical, while WBA has announced plans to wholly acquire CareCentrix.

3. National Health Executive Spending, \$tr



4. US Healthcare Spending by Type in 2023, %

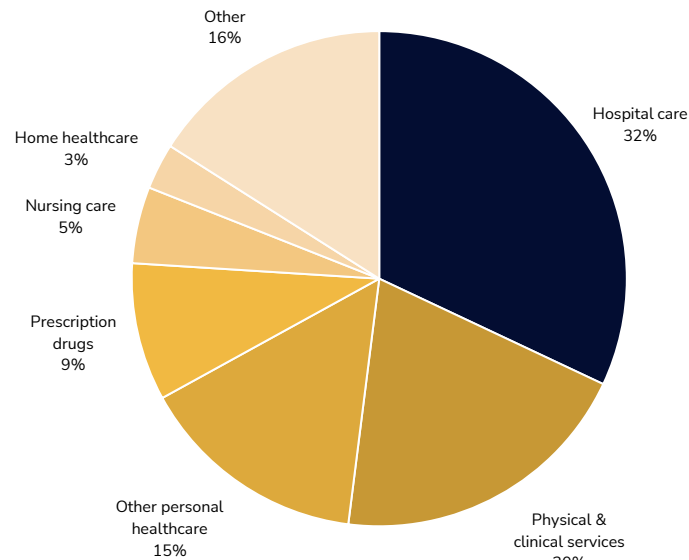
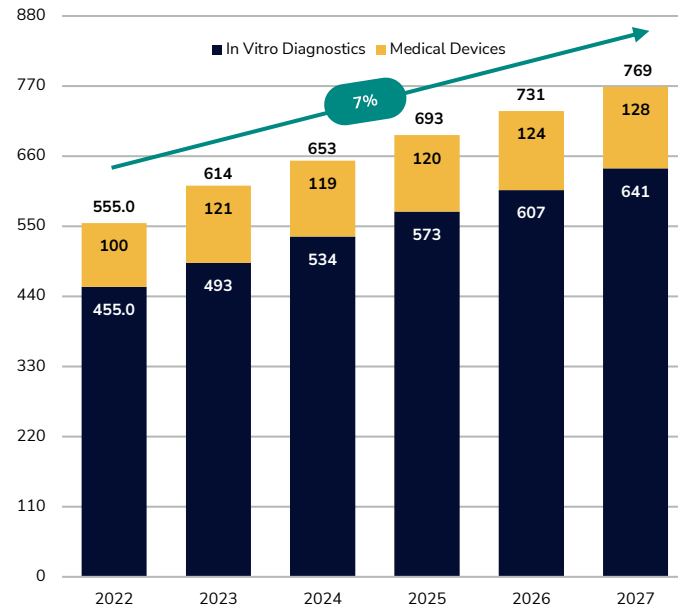


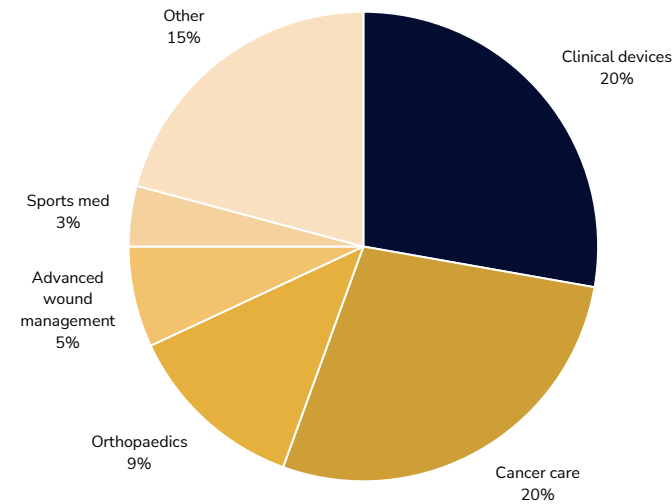
Chart sources: (1) McKinsey & Co. (2) Company reports, Bloomberg. (3, 4) Center for Medicare and Medicaid Services.

Life sciences

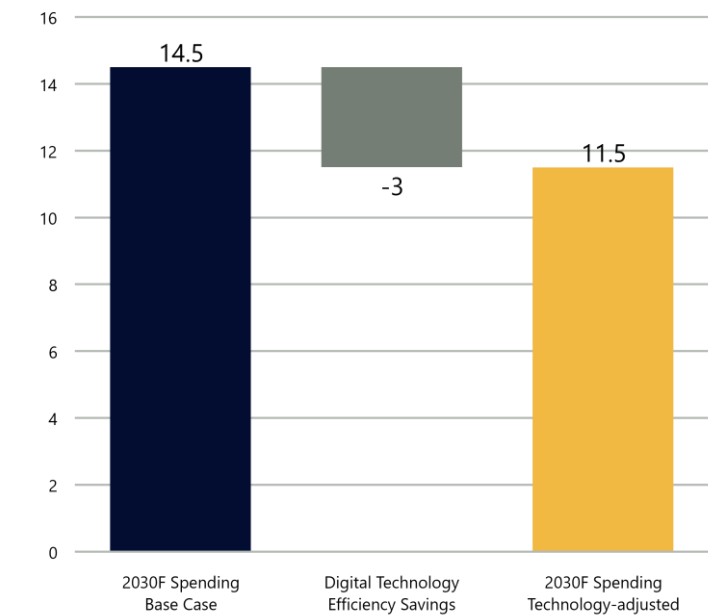
1. Medical Devices Market Value, \$bn



2. Medical Devices Market Composition, %



3. Healthcare Spending and Efficiency Savings, \$tr



Temporary headwinds

Business models in the medical device universe remain susceptible to increasing labour-and-materials costs, ongoing supply-chain-related challenges and deteriorating capital structures arising from higher debt levels.

- 2022 overview.** The medical devices market faced several challenges, including supply chain disruptions, raw material price increases, labor cost increases and an inability to pass price increases through to customers.
- Diagnostic devices.** This market is expected to achieve a 7% CAGR from 2022-2027 (fig. 1). An increase in the geriatric population is expected to propel the growth of the diagnostic devices market. Aging of the population will increase the overall demand for diagnostics in certain areas, such as cancer, diabetes and other age-related diseases. Age-related diseases are also heavily represented in the composition of the medical devices market, with clinical and cancer-related devices comprising 40% of total (fig. 2).

- FDA fees for medical equipment.** Companies importing medical equipment to the US can expect substantial increases in fees relative to 2022: the 510(k) premarket notification fee increased by 56%, while fees for De Novo Classification and Premarket Approval increased by 18%.
- Impact of the strong USD.** Most of the US providers expect a negative impact from currency fluctuations. For example, Medtronic expects its FY23 earnings to be affected by up to 17%. Abbott suffered an impact of -6% on its sales, and the company expects its 2023 results to be affected as well.
- Supply chain vulnerabilities.** Shocks could cause some medical device companies to lose c.3.8% of annual earnings (Pharma: c.2.4%).

- Digital technology** has the potential to capture significant value within healthcare systems around the world, contributing to annual cost savings of \$1.5-3.0tr by 2030 (fig. 3), via a range of innovative solutions such as remote monitoring, artificial intelligence, and digitalization.
- Mergers and acquisitions** in the medical device industry declined in 2022, a trend which may continue into 2023.

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