The bull case for the global healthcare sector

By Pieter Fourie

Our investors have enjoyed healthy returns over time through selective exposure to high quality companies operating in the healthcare sector. In formulating either a positive or negative view of global healthcare businesses one has to consider the US healthcare system being the largest in the world in terms of both drug and medical device sales. It spends far more as a percentage of GDP than any other developed nation at over 16% and accounts for roughly 40% (or $425 billion) of global pharmaceuticals sales and approximately 44% (or $190 billion) of global medical device sales. It is no surprise that all of the companies we invest in within the healthcare sector has significant exposure to the US market

Fundamental concerns on the outlook for healthcare companies are well understood. The two main concerns are:

1. The significant influence that biosimilar drugs will have on existing drugs causing disruption for many industry participants as old drugs go off patent.
2. Branded drug prices in the US are up to 50% to 70% above those in Europe. The Trump administration is clearly focusing much more on pricing which might accelerate the administration's efforts to create incentives to accelerate generic adoption (particularly biologic generics) thus eroding pricing power for the incumbents.

Long term investors should focus on the positive fundamentals driving long term earnings growth within the healthcare industry. We currently invest in a wide range of businesses which covers very different areas of the healthcare market and include Medtronic, Roche, Johnson & Johnson, Waters Corporation, Fresenius Medical Care and Edward Lifesciences. Historically we have also invested in businesses like Amgen and Stryker with great success. We focus our exposure clearly not just to drug related industries but also medical equipment related sub-sectors as well as over the counter healthcare products including nutritious products which are very profitable areas for companies like Reckitt Benckiser and Danone.

For the pharmaceuticals industry we prefer to invest in biopharmaceutical businesses that have portfolios and pipelines for therapies targeting unmet patient needs and serious illnesses. An example of a company that we own is Roche, where a deep drug pipeline is being developed to address areas in healthcare where current cures are either poorly addressed or not addressed at all. The market is understandably focused on the erosion from "new drugs" (biosimilars) taking market share from their existing drugs. We believe that Roche's new drugs either being released or which will be released in due course could replace the lost revenues over time.

Overall we see minimal impact from any government initiatives on medical devices. The customer places greater emphasis on the service level provided by the manufacturer of the device, rather than the quality of the device itself. Take the world's largest medical technology business Medtronic, whose economic value strategy is all about adapting to the transformational change in healthcare towards value based outcomes and aligned incentives for health care providers. We view the fact that Medtronic has taken a leadership position in aligning itself to value based payment models as a constructive step. The company is placing an emphasis on strategic customer relationship and shared accountability for outcomes, enabling it to provide cost benefit solutions to healthcare providers.