Equities
Emerging Markets
Healthcare

EM Sector Keys

Health Care – Somewhere to hide?

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China: We favour CRO and online Health Care

At a time of increasing market volatility, we believe the Chinese Health Care sector offers defensive qualities and structural growth. Although the coronavirus outbreak is having mixed impacts, with drug sales down but online healthcare consultations up sharply, Chinese biotech and innovative drugs are attracting substantial investments and government support, underpinning a multi-year structural growth outlook. The Chinese contract research organisation (CRO) and online healthcare sectors look well placed.

ASEAN: Focusing on private hospitals with growth in medical tourism

In ASEAN, there has been limited supply disruption for private hospitals arising from the coronavirus, although patient volumes have come down. Longer term, the industry should see further growth in medical tourism and rising business volumes with higher penetration in private health insurance, although this comes at the expense of lower pricing power, especially as governments push for greater transparency.

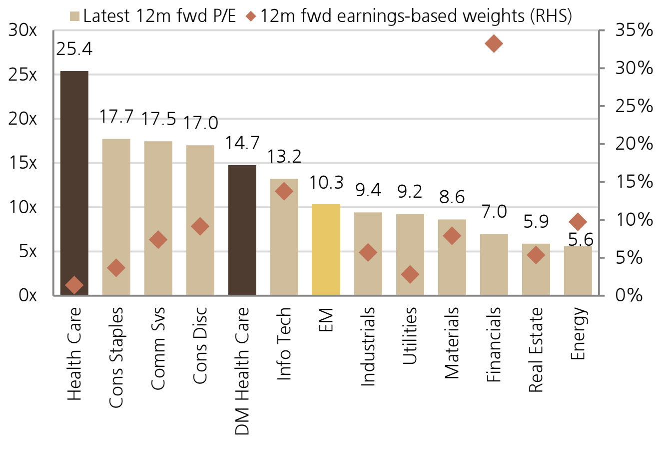
We prefer firms with branded exposure in India; is South Africa ex-growth?

In India, Covid-19 has so far had a minimal impact on inventories, with drug prices unchanged. The sector outlook is supported by the country's relatively young population and positive signals suggesting a relaxation of price controls. We prefer firms exposed to branded drugs (where margins are higher), and medical services like hospitals, diagnostic chains and CROs. In South Africa, with domestic growth slowing and past overseas acquisitions unsuccessful, private hospitals are increasingly shifting focus to returns and execution. We expect an element of relative defensiveness to return to these stocks, as suggested by YTD performance.

Defensive qualities and structural growth: 10 EM Health Care stocks to own

Health Care has been the most resilient sector in EM, and is down 9.5% YTD vs a decline of 21% for MSCI EM. Our stock preferences include: in China, two CRO plays **WuXi AppTec** and **Tigermed**, **PAGD** (online healthcare upside) and **Innovent** (Biotech R&D); three ASEAN private hospitals – **Mitra** (structural growth), **BDMS** (diversified portfolio) and **IHH** (consolidation); and three Indian stocks – **Cipla** (Indian pharma exposure), **Apollo** (30% EPS CAGR post capex) and **Syngene** (leading CRO).

Figure 1: 12m fwd P/E with earnings-based weights



Source: IBES, MSCI, Datastream, UBS

Figure 2: Most favoured stocks

Stock	Rating	PT	2020 P/E	2020E EPS growth	Bloomberg
Ping An Healthcare & Tech	Buy	HK$90.0	n/m	n/m	1833 HK
Tigermed	Buy	¥95.0	56	29%	300347 CS
Innovent	Buy	HK$32.2	n/a	n/a	1801 HK
WuXi AppTec	Buy	HK$116.0	53	26%	2359 HK
Cipla	Buy	□555	17	21.1%	CIPLA IB
Apollo	Buy	□2100	44	42%	APHS IB
Syngene	Buy	□400	30	6.6%	SYNG IB
BDMS	Buy	฿27.0	28	11%	BDMS TB
IHH	Buy	RM6.6	48	3.8%	IHH MK
Mitra	Buy	IDR3,000	31	13%	MIKA IJ

Source: Reuters, UBS estimates

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EM Health Care

UBS Research THESIS MAP

MOST FAVORED

Apollo, BDMS, Cipla, IHH, Innovent, Mitra, PAGD, Syngene, Tigermed, WuXi AppTec

LEAST FAVORED

IPCA, KPJ

PIVOTAL QUESTIONS

Q: What are the implications of the coronavirus outbreak?

Although Health Care has been the most resilient sector in EM YTD, the underlying impact of Covid-19 on companies' fundamentals has been mixed. In China, the coronavirus outbreak has had a major impact on the Health Care sector as people have stayed away from hospitals for fear of infection, resulting in plummeting drug sales in the past quarter. Private hospitals in ASEAN that cater for medical tourism have also seen declining volumes as people travel less and/or postpone elective surgeries. On the other hand, online healthcare consultation in China has seen a sharp rise in demand, with some online service providers seeing a ten-fold rise in newly registered users during the first 15 days of the outbreak, while elsewhere there has been limited supply disruption to date.

Q: Longer term, is an ageing population a challenge or an opportunity?

Overall, an ageing population is viewed as an opportunity for healthcare providers in EM. While there are clearly challenges as governments and a proportionately smaller working population bear the financial burden of caring for an ageing population, the ageing trend and a growing middle class in China, India and across ASEAN are also pushing up out-of-pocket demand for medical services, creating opportunities for medical providers, such as private hospitals and private medical insurance, which remains very underpenetrated.

Q: With higher healthcare costs, is regulatory risk rising?

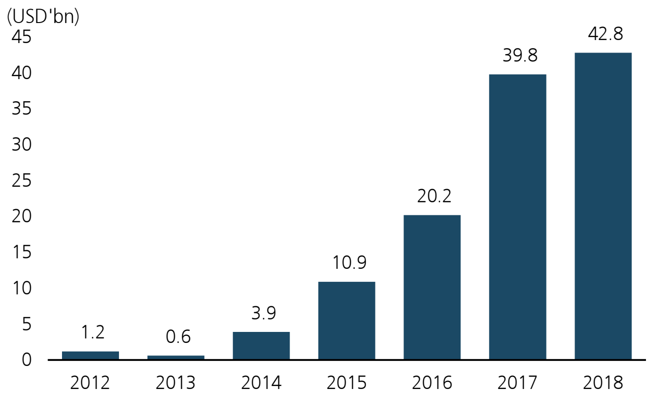
Not necessarily. While governments have introduced price controls in China (e.g. for innovative drugs) and India (e.g. on medical devices in 2015), they have also provided policy support, such as for online healthcare in China, while in India recent discussions point to a relaxation of stent pricing. That said, the Thai government is pushing for greater price transparency to promote competition, while in South Africa there is increasing talk about setting up a national health insurance system, likely to be funded by higher taxes.

UBS VIEW

We are Neutral on Health Care in EM. While the sector remains the most expensive in EM at 25.4x P/E based on consensus 12-month forward estimates, it also boasts strong prospective earnings growth of 21% in 2020, underpinned by a combination of relatively defensive characteristics and structural growth opportunities.

EVIDENCE

PE/VC funds raised targeting healthcare in China



Source: ChinaBio Consulting

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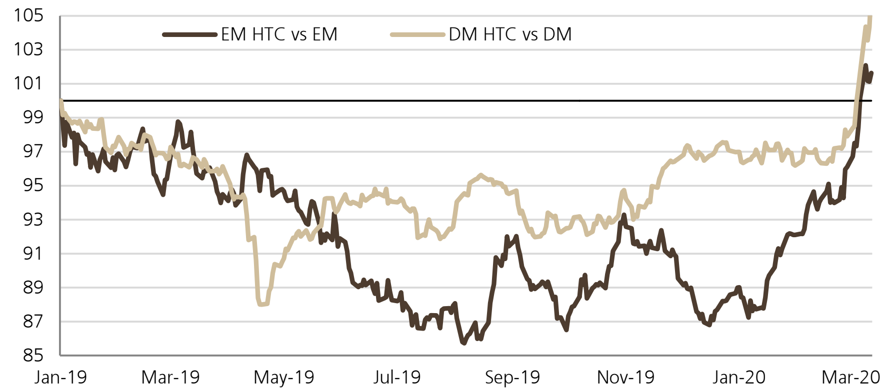
We would like to thank **Sonam Jagga** and **Sagarika Asrani**, our research support service professionals, for their assistance in preparing this research report.

Part 1: Sector composition, earnings and valuations

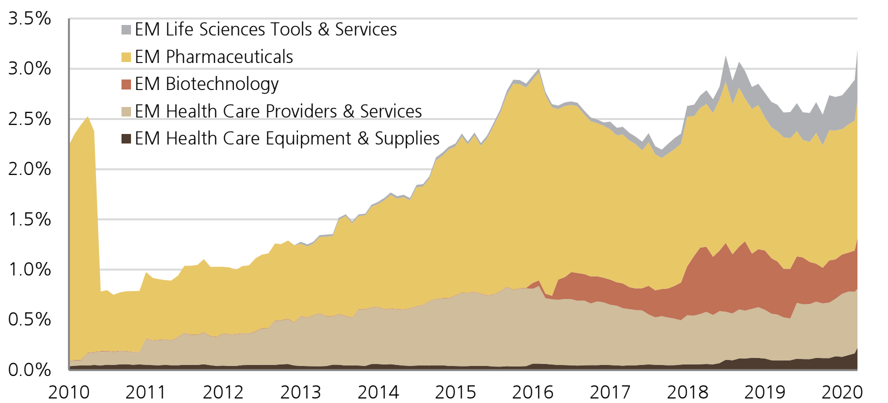
Figure 3: Health Care sector vs market



Source: MSCI, Datastream, UBS. Note: Price indices rebased to 100 on 1 Jan, 2019.

Since the start of the year, EM Health Care has consistently outperformed the EM benchmark. DM Health Care has also beaten the DM index since mid-February, when the spread of Covid-19 concerns outside China coincided with a [jump in Joe Biden's US election nomination odds](#).

Figure 4: Weighting of industries within MSCI EM Health Care

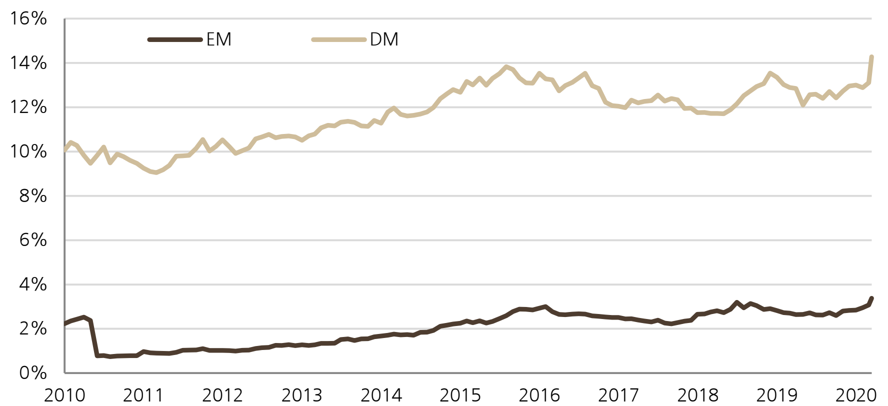


Source: MSCI, Datastream, UBS

Pharmaceuticals has always been the dominant industry in the MSCI EM Health Care Index. Health Care Providers & Services is currently the second-largest segment, followed by Biotechnology, Life Sciences Tools & Services, and Health Care Equipment & Supplies.

The sharp decline in Pharmaceuticals' weighting in June 2010 was driven by the exclusion of Teva, as MSCI upgraded Israel to DM status.

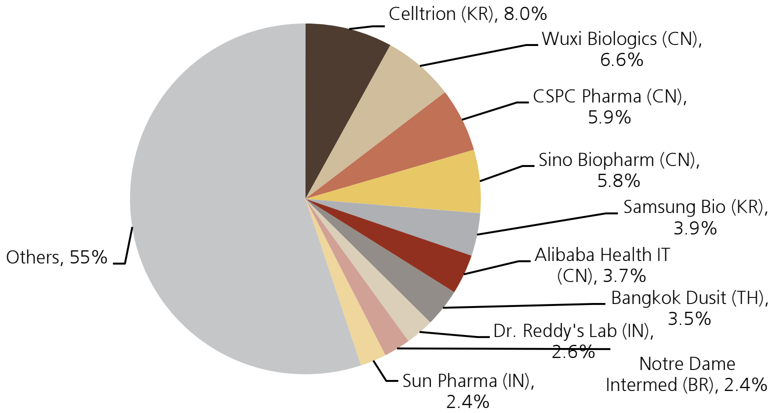
Figure 5: Weighting of Health Care sector within MSCI EM and MSCI World (DM)



Source: MSCI, Datastream, UBS

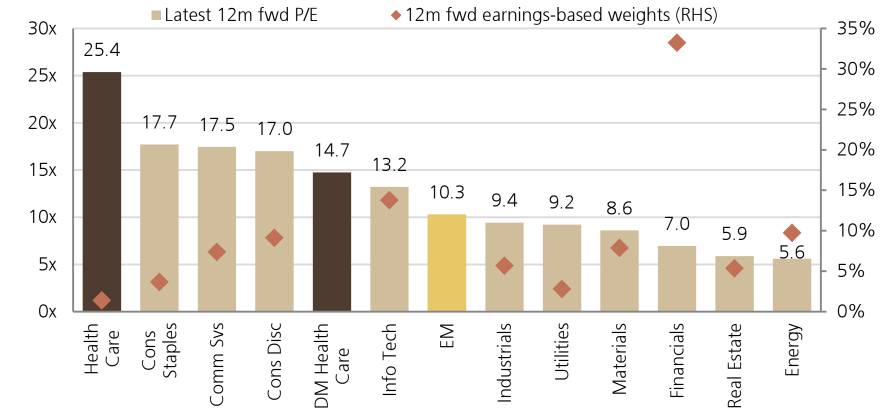
Irrespective of Teva's re-classification in 2010, the MSCI EM index has always been significantly less Health Care-heavy than its DM counterpart – MSCI World.

Figure 6: Biggest stocks in MSCI EM Health Care sector



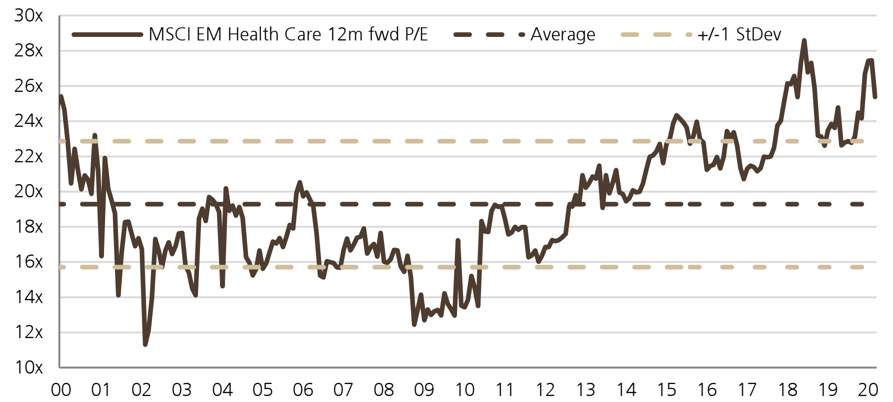
Source: MSCI, Datastream, UBS

Figure 7: 12m fwd P/E with earnings-based weights



Source: IBES, MSCI, Datastream, UBS

Figure 8: MSCI EM Health Care 12m forward P/E



Source: IBES, MSCI, Datastream, UBS

The EM Health Care stock universe is almost entirely represented by Asian companies, with China accounting for more than half of the index's market cap, followed by Korea's weighting of over 15% and India's 10%. The largest non-Asian market in the EM Health Care public equity space is Brazil, which is represented by three stocks that have a combined weight of around 5%.

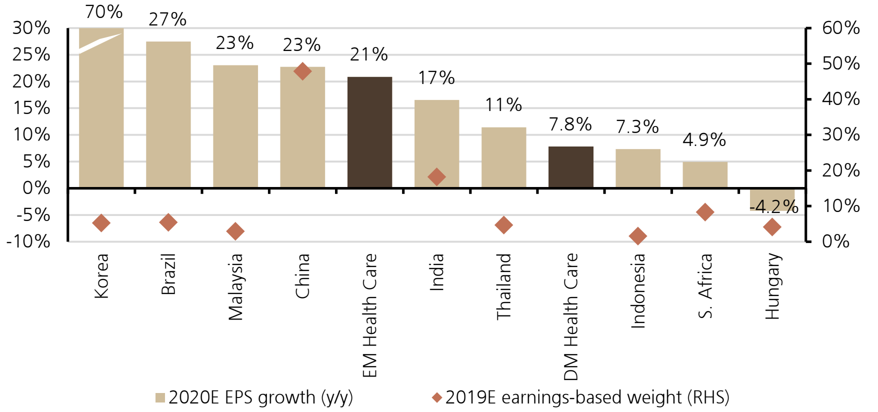
Overall, the sector is fairly fragmented, as the biggest constituent's weight is only 8.0%.

Health Care is by far the most expensive sector in EM, trading at a 12-month forward P/E of 25.4x, which is 30% above the next-richest sector, EM Consumer Staples.

EM Health Care stocks in aggregate are also more expensive than their DM counterparts, which are valued at 14.7x their 12-month forward earnings.

While the valuations of the broad MSCI EM equity benchmark have fallen below their historical means, EM Health Care is still trading close to its all-time highs. In our view, this is driven by a combination of the relatively defensive characteristics of the sector and structural growth opportunities.

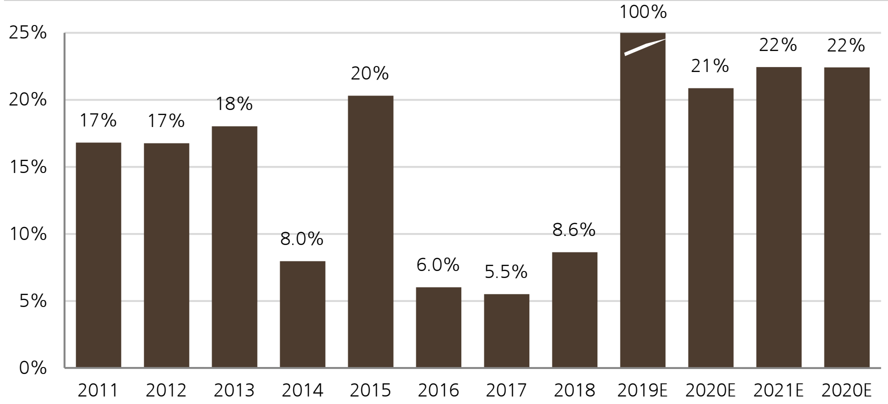
Figure 9: MSCI EM Health Care 2020E EPS growth and its country drivers



Source: IBES, MSCI, Datastream, UBS

EM Health Care boasts a very strong earnings growth profile, as consensus forecasts a 21% EPS expansion in 2020 after earnings doubled last year. The EPS growth forecast for China, which accounts for nearly half the sector's earnings, stands at 23% – in line with Malaysia but below Korea's 70% estimate and a 27% projection for Brazil. India – the second-biggest market within the sector – is expected to deliver 17% EPS growth, according to IBES consensus.

Figure 10: MSCI EM Health Care yearly EPS growth



Source: IBES, MSCI, Datastream, UBS

Looking beyond 2020, consensus expects EM Health Care to continue its healthy pace of earnings accretion, as 2021 and 2022 EPS growth forecasts for the sector are well above the estimates for the overall MSCI EM, which currently stand at 15% and 13% for the next two years, respectively.

The following parts of this report are edited extracts from the [EM Sector Keys Conference Call on EM Health Care](#) hosted on 10 March 2020.

Speaker list:

- **Stella Xing** – UBS China Health Care Research
- **Wendy Song** – UBS China/Asia Health Care Research
- **Nicole Goh** – UBS ASEAN Health Care Research
- **Hemant Bakhru** – UBS India Health Care Research
- **Kane Slutzkin** – UBS South Africa Health Care Research

Part 2: Implications of the novel coronavirus

Question: *Coronavirus is centre-stage among investors' concerns, especially now that it is spreading rapidly in other countries. How is this impacting health care stocks?*

Stella: In China, I think the coronavirus is having a very big impact on the healthcare sector. Rather than benefiting from it, many companies, including most drugmakers, are actually suffering from this event. The reason for that is that we see hospitals as potential centres of contagion. In other words, the government will discourage people from visiting hospital, including most patients with chronic disease. For example, patients with chemotherapy who usually go to hospital every three weeks for treatment, due to the fear of being infected with coronavirus in hospital, will reduce their frequency of hospital visits. As a result, drug sales have actually plummeted in the past quarter, including those for chronic diseases like cancer, and drugs for relatively long-term diseases.

In addition, most surgeries, except for urgent cases, have been delayed. So for medical consumables related to surgeries and also, for example, anaesthesia drugs, sales have also declined significantly in the past quarter. Having said that, pharmacy and online healthcare service providers have been seeing increasing demand during the coronavirus period.

Wendy: I'm going to cover the online healthcare sub-sector and the biotech sub-sector in China. For online healthcare, I think it has been well positioned since the outbreak of the coronavirus. Near term, there has been a sharp increase in demand for online consultation providers or online drug sales providers.

Take Ping An Good Doctor (PAGD), one of the leading online service providers that we cover, as an example. During the first 15 days following the outbreak in China, PAGD had around 10 times more newly-registered users and nine times more daily consultations by new users on their app. This was representative of the surge in demand for online healthcare.

Although consultations are mostly offered for free, they also serve as a way to attract more traffic to the platform. As such, we think they could significantly impact results, although that also depends on the ability of companies to improve their monetisation rate during this period, something that we'll keep monitoring.

Also, a quick update on the biotech sub-sector in China, which focuses on oncology drug promotion and R&D. Sales wise, we think cancer drugs have inelastic demand, but they can inevitably be somewhat impacted by a reduction in hospital visits. As for R&D, per our understanding, clinical trials have also been impacted, especially in February, but most biotech companies say that R&D progress is largely under control at the current stage.

Nicole: In ASEAN, most stocks listed in this sector are private hospitals. With all the Covid-19 cases generally dealt with by the government hospitals, private hospitals would need to refer any such cases to the government hospitals.

Having said that, we are seeing some private hospitals, especially the ones with high medical tourism links, witnessing some decline in volumes. This is because people are travelling less, but also due to incidents of patients going to these private hospitals in both Thailand and Indonesia, when they first developed symptoms of Covid-19 and not being honest or upfront about their condition. This has led to some reluctance on the part of local people to visit private hospitals, have elective surgeries or even visit doctors because of the fear of infection. But, I would say that this impact is relatively small at this stage. It is very well contained for now.

In terms of supply disruption, most hospitals are saying that they are not really seeing this. Their suppliers are still able to provide them with medical consumables, as well as drugs. One mentioned that maybe they are seeing a shortage of surgical or face masks, but so far they have been able to secure their stocks of drugs for their doctors and nurses.

Hemant: Indian companies do import quite a bit of active pharmaceutical ingredients (API) and more importantly other ingredients, and then testing solvents from China. Most firms that I've spoken to have mentioned that they have been carrying inventory to cover a roughly two- to four-month period. So, we could have a shortage situation only after the inventory starts to be exhausted, and that would be at least six to eight weeks from now. Even if that is the case, shortages would be for few products, not across the board, because some of the products have a longer inventory in terms of ingredients and API supply. It seems unlikely that supply would continue to be impacted for that long a period.

On the pricing front, we haven't seen any benefit on pricing yet. Companies haven't really tried to pass on formulation prices. We've seen some uptick in the volumes of flu drugs, like Tamiflu, so volumes have picked up in the case of antivirals, and antibiotics as well.

Kane: In Pharma, we cover Aspen Pharmacare, which has a global footprint. I'll reiterate Hemant's comments around APIs. They don't source a significant amount of APIs from China; there is limited sourcing form China, BUT are carrying the necessary inventory as a buffer. Obviously, should this issue be more protracted, there are likely to be some bigger implications. They don't have any manufacturing facilities in China. We expect business divisions such as thrombosis and anaesthetics to feel the impact of the virus, as elective surgeries are pushed out.

From the hospital side, particularly in South Africa, there has not been too much commentary from the groups, other than just gearing up to take care of any issues around Covid-19. Generally, one would expect the pushing out of all elective surgeries, so anything which is really not an emergency is likely to be deferred. The converse could be that more people needing treatment could result in higher occupancy rates, but we would argue that the negative impact of pushing out elective surgeries would be a larger drag, at least in the near term.

I would also highlight the impact on medical tourism. We cover companies that have global exposure. In the case of a country like the UAE, it could be either that it sends a lot of patients to places like Thailand and maybe those patients now stay within the UAE; alternatively, it may be that UAE is a beneficiary of some medical tourism which will likely dry up, too. Either way, there is most definitely a knock-on effect from the medical tourism point of view. In Europe, we see elective surgeries and a portion of diagnostic imaging services being deferred, too.

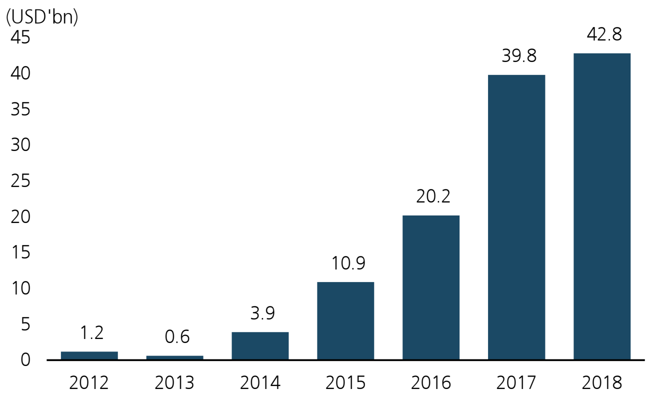
I believe we have not seen a massive impact yet, but should the situation be more protracted, then clearly, and particularly from an elective surgery perspective, the hospitals will likely see some impact.

Part 3: Long-term growth outlook

Question: *Looking beyond the coronavirus outbreak, what is the medium-/long-term growth outlook?*

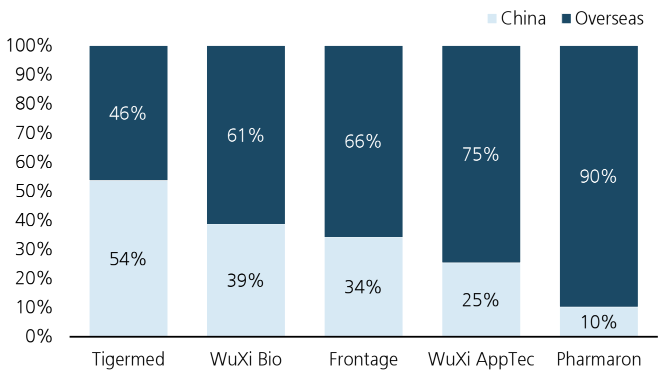
Stella: For China pharma, I think one very attractive sector is China Contract Research Organisation (CRO). We are seeing increasing investment in China biotech and also other innovative drugs. China CRO is also playing a role as a proxy to those increasing investments in biotech and other innovation drugs. For China CROs, they not only serve domestic drugmakers, but also multinational pharma and biotech companies. If we look at their revenue contribution, percentage wise, 60% or more of their revenue is coming from global pharmaceutical companies. So, in other words, China CROs are delivering their high growth: on the one hand, they are riding the Chinese domestic innovation drug boom, and on the other hand they keep gaining global market share thanks to China CROs' superior efficiency and China's engineering dividends.

Figure 11: PE/VC funds raised targeting Chinese healthcare



Source: ChinaBio Consulting, UBS

Figure 12: China CROs' revenue breakdown by region (2018)



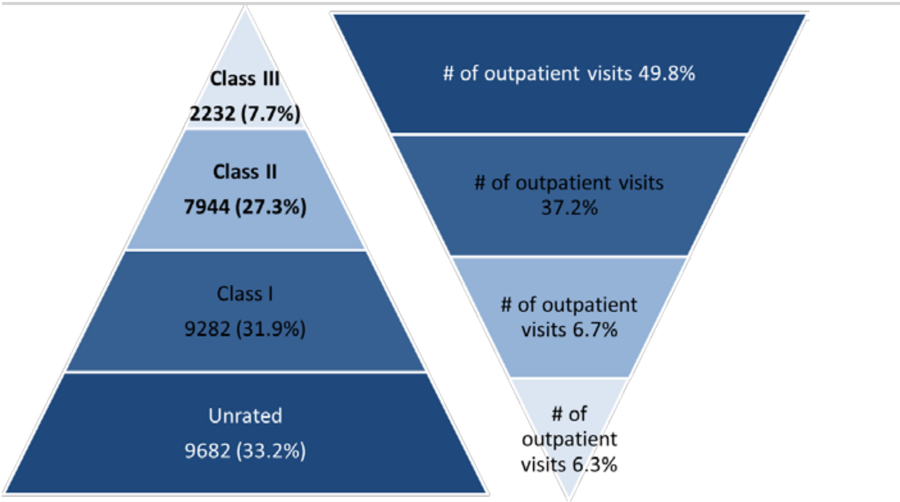
Source: Company data, UBS

Wendy: I think online healthcare is also an attractive sector from a long-term perspective. First, online healthcare offers the most cost-effective way to solve the imbalance of medical resources in China (see Figure 13), as quality resources remain scarce and highly concentrated in the high-level hospitals of big cities, while on the demand side, it could be more evenly spread. This is a cost-efficient way to solve such issues.

To give some context, China's healthcare market is worth about Rmb4,000 billion in terms of revenue. So even if online in the long-term can take a single-digit market share of that total, that can be worth hundreds of billions in terms of revenue.

And secondly, I think the sector is still at a very early development stage. There have been more supportive policies in the past two years, and we expect more going forward, and although this could take years to happen it would gradually solve the issue for the industry in terms of establishing online platforms, shifting some offline consultations and offline drug prescriptions to online, and also committing more investments for online healthcare.

Figure 13: Supply and demand in China — mismatch of medical resources



Source: F&S, UBS

With the continuous reform progress, we expect the visibility of the industry and also the major players to keep improving. Meanwhile, the coronavirus could also help the reform progress, enhancing government awareness of the importance of online healthcare, and also increase public awareness of and acceptance of the industry.

Nicole: Private hospitals in Thailand, Singapore and some parts of Malaysia have been trying in the last few years to grow their medical tourism business. Pre-2016, quite a number of medical tourists in the Thai hospitals, for instance, were from the Middle East, and then the medical tourists for Singapore and Malaysia are mainly from Indonesia.

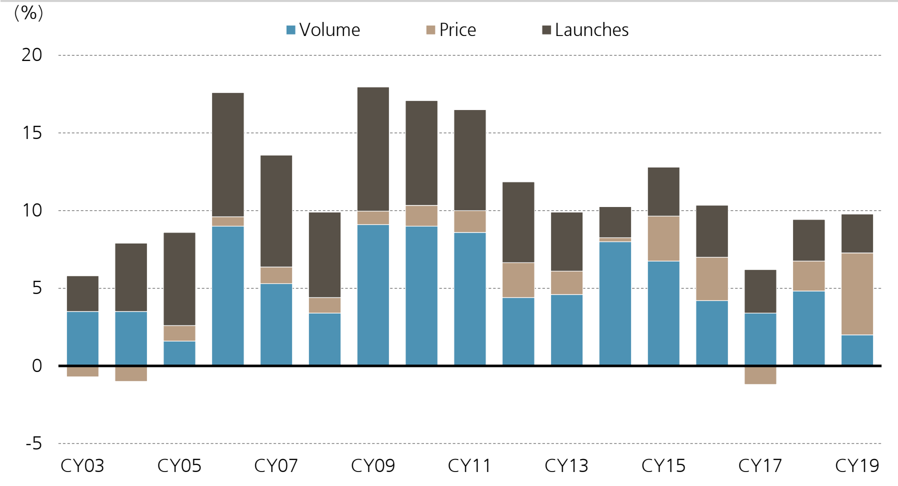
In the past one to two years, there has been increasing focus on trying to attract Chinese tourists, as well as those from some of our neighbouring ASEAN countries, too. For instance, Thai hospitals were trying to attract medical tourists from Laos, Myanmar, Vietnam and Cambodia. For Singapore and Malaysia, they will continue to try and attract Indonesians.

Beyond Covid-19, medical tourism could be a growth area. For some Thai hospitals, like Bumrungrad for instance, it's a single standalone hospital in the heart of Bangkok. They derive 60% of their revenue from medical tourism, versus the likes of BDMS in Thailand or Parkway in Singapore, under the listed company IHH, they would derive about 30% of their revenue from medical tourists.

Hemant: If you look at Indian pharma, there's a dichotomy amongst stocks: some stocks, which typically are the larger names, derive part of their revenues from emerging markets including India, and part from the US. But, if we come to some of the mid-tier names, which have high exposure to domestic markets, the key growth driver is India. If you look at the domestic market growth rate, it has been declining over the last two to three years, partly because of some policy changes earlier, and partly because a lot of growth in India has been driven by increasing accessibility and affordability over the last two decades or more. And, the drivers are still prevalent from a longer-term perspective, but near term, that could constrain especially the volume growth part of the business.

And if you look at branded versus the unbranded drugs, India is largely a branded generics market, with 80% of value coming from there. And the rest is from unbranded generics and patented products. So, we prefer companies which are more exposed to the branded side, although unbranded has also been growing at pretty much a similar level, but we expect margins on the branded side to be better and more sustained over the long term.

Figure 14: India market growth



Source: IMS Health, UBS

We also like domestic healthcare services, like hospitals and diagnostic chains. And following Stella's comment on contract research organisations, we have a couple of those as well. One of the listed ones is Syngene, which is an arm of a company called Biocon. So, that's one of the leading CROs in India. But obviously they are more focused on international business than the domestic business.

Kane: To some extent, the sector is now ex-growth; the groups face increased pressure in the acute sector, c90% of South African hospital revenue. That pressure has generally been driven by macro trends and funder intervention. This has driven investment into non-acute services. This is what we are seeing in the sector at the moment. South African companies are making efforts to reduce reliance on the acute sector, where there is big margin pressure, and move towards other areas of healthcare delivery – whether it be mental health, primary healthcare, or even day hospitals – just to alleviate the pressure experienced on the acute side. It's important to note, though, that most complementary services in South Africa will generally come at a lower margin.

I believe the ex-growth status is driven by the lack of growth in the pool of medical insured lives, which has largely dried up over the last five years, which in turn has driven offshore expansion, often unsuccessfully so in recent years. We have come full circle though, to the point where some are now focusing purely on cash returns.

But essentially what is happening is a movement down the continuum of care. And perhaps those that can innovate and digitise might also be winners of the future. We are starting to see South African groups talking more about digitisation, which could help them become more efficient and lower costs of healthcare. The reality is that top lines and margins are under pressure, and providers are increasingly focusing on alternative avenues of growth to prop up the top line. But the sector does have excess capacity.

Part 4: Ageing population

Question: Do you view an ageing population as a challenge or an opportunity?

Nicole: I consider the ageing population to be an opportunity for most countries in ASEAN. Governments have been trying to increase spending on healthcare, but at the same time they have budget constraints. And to a certain extent, healthcare costs have been coming from a relatively low base compared to some of the more developed countries. For a lot of the middle-income population and the wealthy sector, medical costs are increasing. That just means government, public service is not a very good alternative. This creates an opportunity for private hospitals.

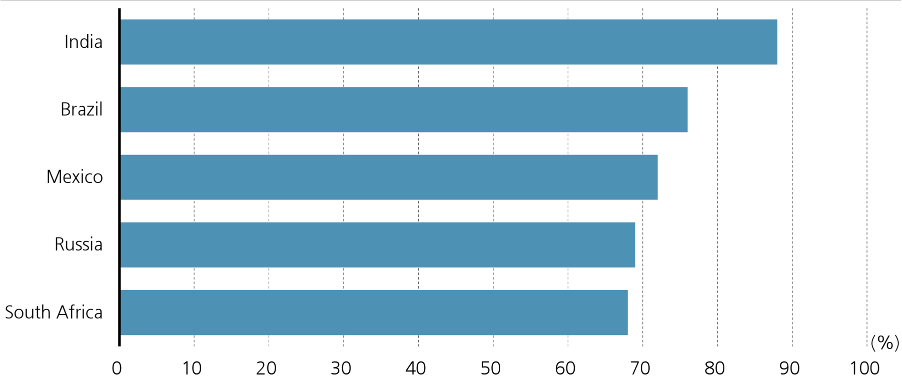
Stella: I would say that this is both an opportunity and a challenge. In China, senior citizens (i.e. over the age of 60) as a percentage of the total population increased from 12.4% in 2010 to 17.9% in 2018. So, within eight years, the percentage increased significantly.

In China, we have universal medical insurance, which is the government insurance covering everybody. Usually, it's young working people who pay for that, while senior citizens consume it. But, if we see the ratio of senior citizens increasing further, it would mean there will be an increasing number of people using medical insurance while there will be fewer people paying for it. Actually there is already a big proportion of China's medical insurance revenue directly coming from government fiscal spending. We wouldn't call that a deficit, but that's a potential challenge.

If this ageing trend continues, we will see increasing demand for all medical services and for drugs. But, on the other hand, we will also see a very stretched budget. What's the game-changer? Is it a dead end? The answer is definitely no. The situation is complicated, but China is a country covered by government medical insurance, so if we only have that one source of payment the situation is tough. But, on the other hand, this provides huge opportunities for private medical insurance, which is very underpenetrated in China. Even without business medical insurance, companies in China who cater for patients paying out-of-pocket are likely to succeed.

Hemant: For India, I would say it's still an opportunity. India is a relatively young country with roughly 10% of people above 60 years old, or senior citizens. Yes, the country will continue to age as fertility rates continue to drop, but I think that is probably still a long time away.

Figure 15: Out-of-pocket as a % of total healthcare spend



Source: Swiss Re, UBS

More importantly, India is a largely out-of-pocket spending market, so the pharmaceutical spend is predominantly out-of-pocket. The in-patient healthcare spend is covered, and is getting increasingly covered, though it is largely still out-of-pocket. Prime Minister Modi launched a health insurance scheme, commonly known as Modicare, in September 2018. The scheme provides insurance of up to US$7,000 per year of value for in-patient treatment. So, as it expands and gains more traction, I think we will see some increase in spend from the government side. But, for now, I think, considering that it's largely out-of-pocket driven market, we still view an ageing population as a positive for the market.

Part 5: Regulatory risk

Question: The cost of private health care appears to be rising, in some countries, sharply. Does this suggest that policy/regulatory risk is likely to rise?

Hemant: We've seen repeated announcements on price controls; obviously there was a major overhaul of the pricing control system on drugs, particularly in 2012, 2013. And then we also saw some controls coming on medical devices and that was the first ever in 2016, when we had some controls put on stent pricing and then knee implants as well.

But, over the last two or three years, especially in 2019 and 2020, we have seen some positive signals for the companies. For example, stent price controls put in place in 2016 were absolute controls in terms of approximately US$500 max, for the drug-eluting stent, but very recently we have seen discussion on relaxing those rules for stents that offer specific advantages, like bioabsorable stents. Even on pharmaceutical drug pricing, there have been discussions with CEOs and owners of various pharmaceutical companies, and the discussions have pointed towards some relaxation of incremental controls. If that is the case, then the companies should be in reasonably comfortable territory.

Right now, around 15% of the value of the pharmaceutical market in India is under price control. So, if that remains in that range, that would be a positive for the companies.

Kane: I think it is important to note that the funders of medical aid have probably in the last three to five years acted as quasi-regulators themselves. The SA hospital groups generate about 90% of their revenue from the insured lives pool. The macro has been weak, and therefore we have seen pressure on those insured lives, while higher insurance claims have led to greater funder-led intervention in recent times. This has negatively impacted the hospitals, both in terms of volume – i.e. case management, which we think has probably run its course somewhat – and pricing, which we believe may have some legs, as the introduction of lower-cost networks gains more traction.

Looking forward, we are seeing increased regulatory talk and noise in the South African sector, particularly around the introduction of National Health Insurance, which is essentially a bill to create a single fund to comprehensively cover the healthcare needs of the entire population. The private and public healthcare segments are roughly equal in terms of healthcare spend, yet the private sector only serves about 15% of the population.

So we see an unequal allocation of resources/skills, ultimately driving inequitable access to healthcare, giving rise to NHI. It is to be funded by taxes, amongst other avenues, and quite frankly, there isn't enough money to go around, while critical skills are in shortage. So we think it's rather unlikely the Bill in its intended form will be delivered in reality; we are more likely to see a model starting small, covering primary healthcare, and as time goes by, they can look to add coverage and services to that. But we think it is unlikely that it will impact the private sector in the next five to 10 years, negatively speaking, because the initial work would really be around the insured population.

If anything, though, we do think that it does potentially provide some opportunities to the private sector. There is excess capacity in the system; hospitals operate at c65-70% occupancy, and any new volume would obviously help them, albeit it would come at lower pricing. We do anticipate that pricing from an NHI-type patient would be much lower, but there is a high level of fixed cost in the system and facilities could gain by seeing higher occupancy. We do not expect a negative impact on the hospitals in the short to medium term. We are likely to see some of the groups looking to take advantage of or try to leverage off the theme.

Nicole: In ASEAN there's always some debate with regards to healthcare prices being too high, especially at private hospitals, or private hospitals making too much money from dispensing drugs. But governments have not been very successful in imposing price controls for private hospital services or for drugs *per se*. I think this is mainly because some of the larger hospitals are listed. They do invest a lot in trying to attract medical tourists. So, if price controls are imposed, it just means that these hospitals are not incentivised to invest in their facilities.

What has happened is that governments have then tried to increase price transparency rather than just putting in price controls. So far, in 2018, the Thai government formed a working group to study the high prices of drugs in private hospitals. One minister suggested that Thailand put price controls on drugs and medical supplies by imposing a price ceiling on drugs, medical supplies and medical services in private hospitals. But I think that didn't materialise. What they did in the end was to make all the private hospitals disclose their list of drugs and their prices on a government website to make it transparent to all patients.

There's definitely this push towards a greater price transparency. There could be more pressure on prices but, by and large, the average revenue per patient growth (from a combination of both price increases and increased complexity) that the private hospitals have been experiencing has been healthy, at mid-single digits on a per-annum basis.

Stella: The Chinese government has done a very good job in price control. Every year, 30 drugs (mainly generics) undergo a bidding process known as group purchase organisation (GPO), hosted by the Chinese government. There will be three or four players bidding on the price of generics, with the cheapest winning large government contracts.

The Chinese government wants to cut generic prices so that they can spend more on innovative healthcare drugs, in the process upgrading the government insurance cover.

Wendy: I also want to add some comments on innovative drugs. We do see the government cutting prices for generic drugs in favour of innovative drugs. But for innovative drugs, the government also has another rule or system imposing prices on such drugs, allowing them to spend more on innovative drugs, given the tight budget of the overall medical insurance.

The government negotiates with innovative drug providers for an acceptable price in order to get reimbursement, and they also renew and re-negotiate the price every two years, so that has become a routine practice. We also expect price control in innovative drugs, although it may not be that stringent compared with the generic price.

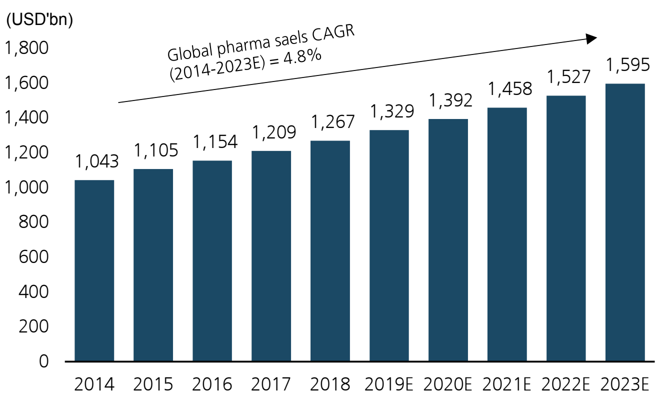
For online healthcare, it is a pretty new industry here. As online is a cost-effective way to improve the quality of the medical system, something the government is aware of, we believe it will promote this industry. Also, the development of this industry is highly related to the reform progress. As it is also a new area for the government, we think there might be some back and forth on regulations during the process. Overall, the government is working towards opening more opportunities in the healthcare industry. We think that this trend will continue.

Part 6: Stock preferences

Question: *What is your sector stance and stock preferences?*

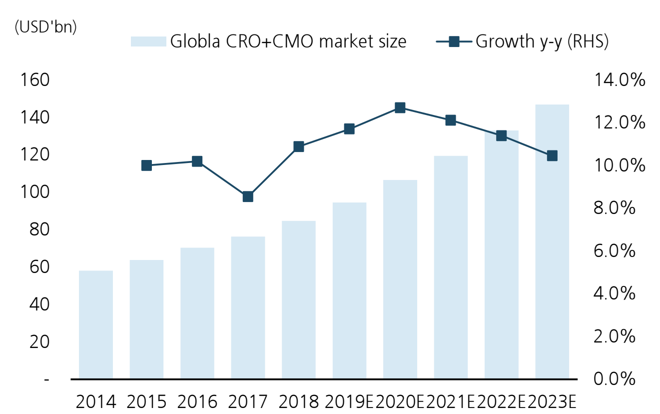
Stella: Our favourite sector in China is CRO, contract research organisations. We have a very positive long-term view mainly because globally large pharma companies are relying more on CRO companies. Global pharma sales are growing at 4% versus global CRO sales growing at 10%. In both China and globally, we are seeing increasing investments in drug innovation and development, which should benefit CRO.

Figure 16: Global pharma sales (2014-23E)



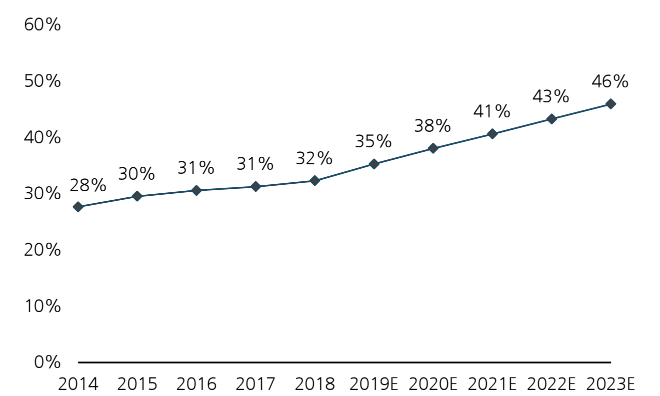
Source: Evaluate Pharma, UBS

Figure 17: Global CRO+CMO sales growth (2014-23E)



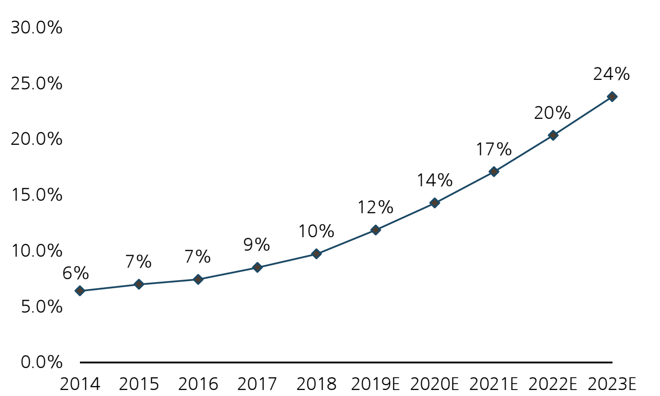
Source: Frost & Sullivan, UBS. Note: CMO = contract manufacturing organisations.

Figure 18: Global CRO revenue to pharma R&D expenses



Source: Frost & Sullivan, UBS

Figure 19: Chinese pharma R&D spending as % of sales

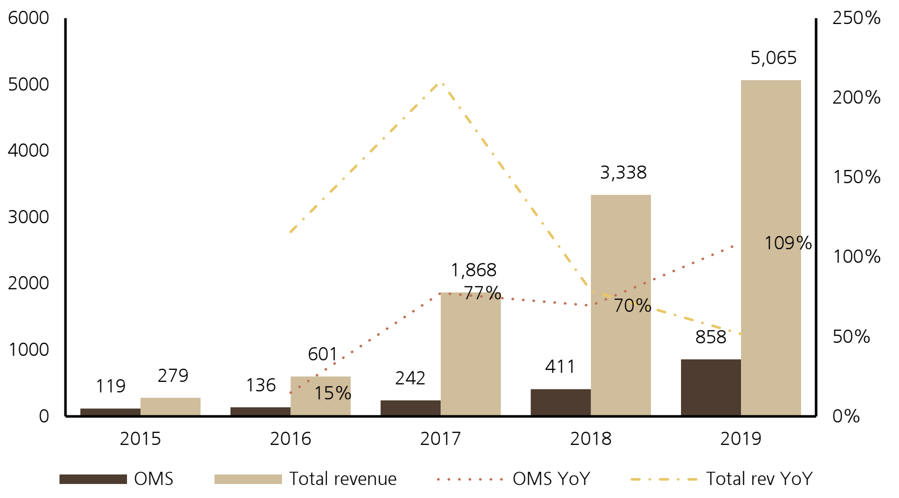


Source: Frost & Sullivan, UBS

We like CRO companies that are high quality, and have good corporate governance and attractive growth. These include **WuXi AppTec (link)**, **Tigermed (link)**, and **Pharmaron (link)**. Read more in our China CRO sector initiation report published in January 2020 (link).

Wendy: Among online healthcare stocks, our preference is for **Ping An Good Doctor** (PAGD), for two reasons: (1) positive signals on its business model, with fast growth of its core segment OMS (online medical service), along with increasing user activity, a higher monetisation rate, and fast growth of online consultation membership; and (2) it could benefit from the continued support from government in setting pricing and reimbursement for online consultations, where we think PAGD is a big player.

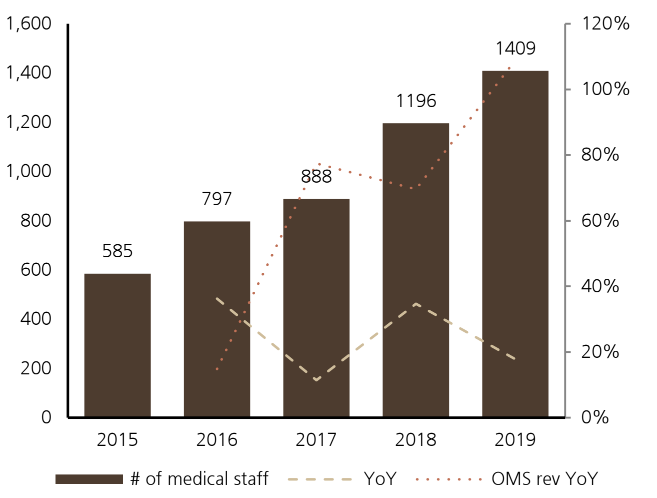
Figure 20: OMS and total revenue growth (Rmb '000), PAGD



Source: Company data, UBS

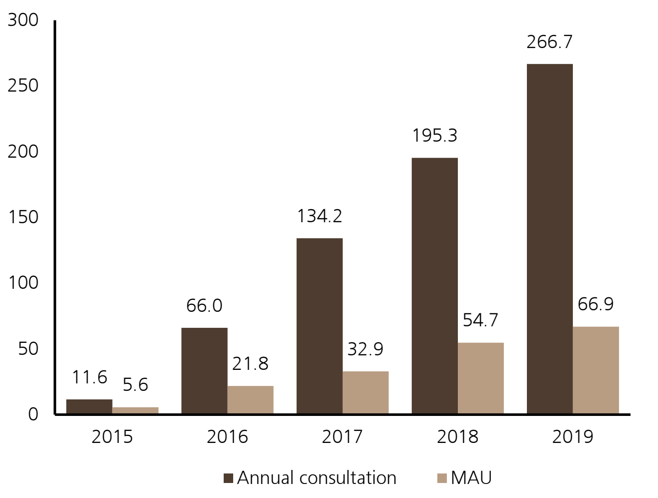
Biotech wise, we pick Innovent, given the proven and more comprehensive capability in R&D, commercialisation and business development activity compared to peers.

Figure 21: PAGD: No. of medical staff on the rise but falling far behind OMS revenue growth



Source: Company data, UBS

Figure 22: PAGD: Annual consultations and MAU (m)



Source: Company data, UBS. Note: MAU = monthly active users.

Nicole: Among ASEAN markets, we believe the best long-term structural growth story is Indonesia, given healthcare is highly underpenetrated. So, the stock that we like here is **Mitra Keluarga**. It's a private hospital, largely a community hospital, in a suburban area.

In Thailand, I think looking past Covid-19 and also the recent tumble in the oil price, the stock we like is **BDMS**, which is **Bangkok Dusit Medical Services**, as they have a very diversified portfolio, with about 50 hospitals across Thailand with different branding and market segments. It is a play on both medical tourists and local Thai people.

And we also like **IHH** in Malaysia, a conglomerate with hospitals around the world, with the largest contribution coming from Singapore. We like it because it's trying to consolidate its previous expansion, and it should start doing better from here on.

Hemant: We have four different themes, all domestic. One is a large pharma company with high exposure to India, **Cipla**. We also prefer **Apollo** hospitals within the healthcare theme. Apollo is coming out of a high capex phase. We expect strong growth over the next two, three years, at around a 30% CAGR. And, we have seen evidence of that over the last four quarters as well.

Among diagnostics, we prefer **Dr. Lal Pathlabs**; and, finally, in the CRO segment, **Syngene,** as I mentioned earlier. All four are rated Buy at UBS.

Kane: In an absolute sense, hospital stocks don't have attractive stories with layers of growth. They do, however, have less risk than in prior years, due to the focus on cash returns and turning around existing ops, and as a result could prove to be more defensive in what is a rather uncertain environment.

To play that theme, our preferred name is **Netcare**: it is a pure SA story, with limited growth, but possesses a dividend underpin (yield of 6%) with some upside risk in share buybacks. Trading at 11x FPE and 7x EBITDA.

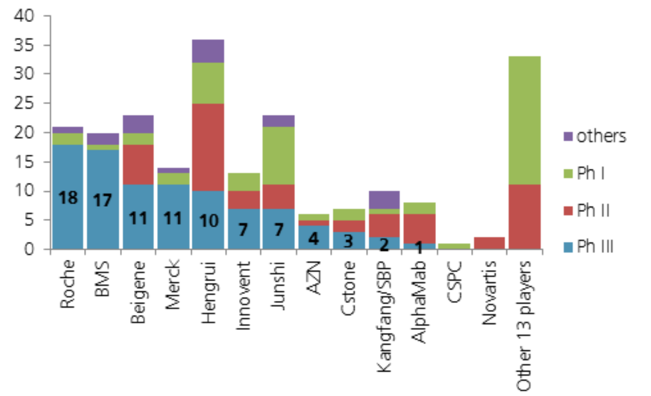
Life Healthcare is another name, generating roughly 70% of its revenue in SA, but it has a diagnostic business in Europe, which has largely disappointed since acquisition but is potentially troughing in the MRI market. Those are our two preferences; both are Neutral rated.

Part 7: Q&A

Question 1: We've seen a number of emerging companies focus on innovation drug research and development in China. What is the outlook for this segment? Will it concentrate over time? What business models are likely to do best? Lastly, what are the key risks for this segment?

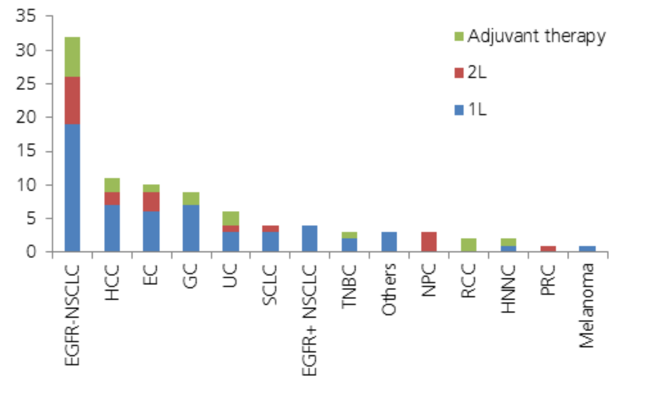
Wendy: In China, given the trend of cutting the generic price and favouring drug innovation, the direction for innovation is pretty clear. We are positive on the outlook for the China biotechs. I think over the long term we could see a divergence from the current situation. On the one hand, most China biotech firms today are not truly undertaking innovation. They produce "me-too" drugs rather than truly innovative drugs. This is a crowded area with a lot of competition. For example, in China, we have over 30 developers for PD-1, which is definitely much more than globally. We think biotechs developing me-too drugs will consolidate in the long term, given the high cost of running clinical trials and low market shares for late-comers.

Figure 23: PD-(L)1 clinical trials in China, by developer



Source: CDE, UBS estimates, as of July 2019

Figure 24: PD-(L)1 Ph III trials in China, by indication



Source: CDE, UBS estimates, as of July 2019

On the other hand, for China's biotech companies, although the technology is still behind that of US firms, the introduction of more talent from overseas will likely result in convergence in the years ahead. Over the long term, we expect to see the emergence of true drug innovation in China.

In terms of business model, I think you must be a fast follower to launch a me-too drug or me-better drugs in China earlier, so that you can gain meaningful share. Another way is to do true innovation and create a real niche market or even access to the global market.

As for the key risks, I think competition, especially for me-too drugs, is one where we're already seeing fierce competition such as in PD-1 areas. So, I think price competition could be one of the key risks.

Question 2: What is the Chinese government or the Chinese National Medical Products Administration (NMPA) doing that proves they are supporting the innovative drug industry in China?

Stella: Before 2017, Chinese government medical insurance paid for no innovation drugs, no matter if they were produced by MNCs or by domestic Chinese companies. Instead, before 2017, China medical insurance paid only for generics, both foreign generics and domestically produced generics.

The government wants to support innovative drugs. The first purpose was to allow more Chinese patients to get access to innovative drugs, whether the innovation drug was produced internationally or domestically. From 2017, for the first time, those innovative drugs were included on the reimbursement list. As Wendy mentioned before, for innovative drugs to be included on the reimbursement list, they needed to have negotiated this with the government, with big price cuts.

Before 2017, government money went to both MNCs and Chinese companies for their generics. After 2017, government medical insurance money has gone to both MNCs and Chinese domestic companies for innovative drugs. The payment changed. For example, a domestic company like Hengrui will tell you their strategy is to focus on more innovative drug development while seeing generic prices decline. If you ask MNCs with business in China, they will tell you the same thing.

The Chinese government also supports domestic drug producers by giving approval for both "me-too" drugs and innovative drugs to ensure that prices are not too high. Other forms of support include government grants and tax benefits to biotech companies.

Question 3: Have you seen signs within the Chinese NMPA that they're raising their own quality bar internally?

Stella: Yes, they are definitely raising their standards. The Chinese NMPA doesn't have the same quality standards as its equivalent in the US, but they are catching up. For example, in assessing a new drug, drug reviewers working in China, or NMPA, will either visit US companies or they ask the applicants, which are drug makers, to give them training to better understand the drug. They may do this with several MNCs in order to understand what's the most advanced practice globally. Again, clinical trial data and all the applications today in China are viewed as trustworthy. They are near global standards.

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Buy	FSR is > 6% above the MRA.	44%	32%
Neutral	FSR is between -6% and 6% of the MRA.	41%	29%
Sell	FSR is > 6% below the MRA.	15%	20%
Short-Term Rating	**Definition**	**Coverage[3]**	**IB Services[4]**
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%

Source: UBS. Rating allocations are as of 31 December 2019.
1:Percentage of companies under coverage globally within the 12-month rating category.
2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.
3:Percentage of companies under coverage globally within the Short-Term rating category.
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Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
Apollo Hospitals Enterprise	APLH.BO	Buy	N/A	Rs1,513.15	13 Mar 2020
Aspen Pharmacare Holdings[20]	APNJ.J	Neutral (CBE)	N/A	RCnt8,700	13 Mar 2020
Bangkok Dusit Medical Services[13]	BDMS.BK	Buy	N/A	Bt19.90	13 Mar 2020
Biocon Limited	BION.BO	Not Rated	N/A	Rs287.65	13 Mar 2020
Cipla Ltd.	CIPL.BO	Buy	N/A	Rs425.20	13 Mar 2020
Dr. Lal Pathlabs	DLPA.BO	Buy	N/A	Rs1,571.25	13 Mar 2020
Hangzhou Tigermed Consulting	300347.SZ	Buy	N/A	Rmb72.70	13 Mar 2020
IHH Healthcare Berhad[22]	IHHH.KL	Buy	N/A	RM5.38	13 Mar 2020
Innovent Biologics Inc	1801.HK	Buy	N/A	HK$28.75	13 Mar 2020
Ipca Laboratories	IPCA.BO	Sell	N/A	Rs1,320.20	13 Mar 2020
KPJ Healthcare Bhd	KPJH.KL	Sell	N/A	RM0.91	13 Mar 2020
Life Healthcare Group	LHCJ.J	Neutral	N/A	RCnt2,192	13 Mar 2020
Mitra Keluarga Karyasehat[4]	MIKA.JK	Buy	N/A	Rp1,855	13 Mar 2020
Netcare Limited	NTCJ.J	Neutral	N/A	RCnt1,711	13 Mar 2020
Ping An Healthcare and Technology[2, 4, 16]	1833.HK	Buy	N/A	HK$70.55	13 Mar 2020
Syngene International	SYNN.BO	Buy	N/A	Rs279.30	13 Mar 2020
Wuxi Apptec[4, 13, 18]	2359.HK	Buy	N/A	HK$102.20	13 Mar 2020

Source: UBS. All prices as of local market close.
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