



REGULATORY CHANGES CLOUD HEALTHCARE, YET LONG-TERM GROWTH OUTLOOK INTACT

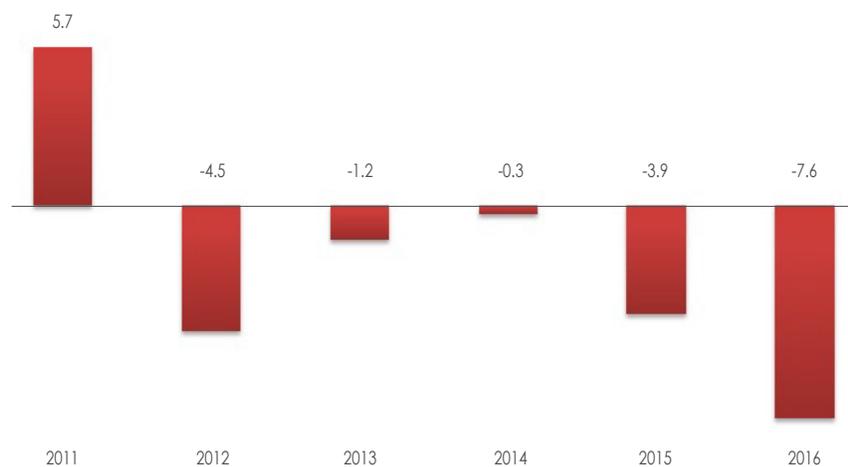
KEY TAKEAWAYS

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The revenue and earnings outlook for the global healthcare sector has come under a cloud recently as governments have aggressively pressured drug manufacturers to lower prices. Service providers are also facing lower earnings growth as governments try to reduce costs and rebuild the financial viability of their healthcare systems. Uncertainties related to sweeping reforms such as the replacement of the Affordable Care Act in the U.S. have added to the healthcare industry's troubles. The long-term demand growth outlook is brighter in emerging countries, where healthcare consumption remains low. However, governments in those countries are also trying regulatory restrictions on drug pricing and other measures.

The global healthcare sector is facing headwinds in the form of regulatory overhaul and tighter pricing negotiations by populist governments, especially in the U.S. Even as drug makers and healthcare services providers were reshaping their strategies to align with the Affordable Care Act introduced by the previous U.S. administration, the sector is facing the reversal of several key features of that initiative.

Revenue growth rate for large pharma firms*, Y-o-Y



Data in percentages

Data source: Bloomberg
*Bloomberg's Global Large Pharmaceuticals Valuation Peer Group

While the new administration has repeatedly talked about repealing the Affordable Care Act, there is no clear picture of the new structure that would take its place. This has added to the uncertainty facing the sector, as yet unsure of another about turn by a future administration.

In contrast, there is more political agreement over pressuring drug makers and service providers to reduce prices. Considering the fragile financial state of most government-run healthcare programs across the developed world, this was only to be expected. The industry has countered that higher prices are necessary to sustain new research and innovation. It is also argued that higher prices, after trade discounts, have had only a moderate effect on the revenues of drug makers. Nevertheless, it is likely that the pressure on the industry to make healthcare more affordable will remain. Governments may also try to increase the market access for lower priced versions, such as generic drugs.

Despite these short to medium term uncertainties, the long-term demand outlook for the sector remains robust. Most developed economies have aging populations and demand for healthcare products and services is likely to only grow. The short-term pressure on pricing and margins have kept sector valuations relatively low. This could boost mergers and acquisitions activity in the coming years, as the larger companies with strong cash flows look to strengthen their product offerings or enter new market segments.

The long-term demand outlook is brighter in emerging countries, where healthcare consumption is still very low. Growing incomes and rising health awareness could boost demand, especially in countries with large populations that would allow sufficient operational scale and efficiencies. Government policy is also crucial in enabling a favorable environment to achieve this growth potential. The basic healthcare services in several of these countries are controlled by the government or are heavily subsidized. As a result, some governments have instituted price controls for the most widely used drugs and other healthcare services. Nevertheless, much of these restrictions are in the low margin commoditized segments and leave the industry sufficient space for growth.

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