

## Healthcare Sector Report

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### Overview

Health Care is the third largest sector making up for 12% of the market, accounting for about a fifth of the economies GDP. Healthcare has four main subsectors: Pharmaceuticals, Biotechnology, Healthcare Equipment and Supplies and Healthcare Providers and Services. Healthcare providers and services are the owners and operators of Health Care Facilities and Managed Health Care. Health Care Equipment and Supplies includes companies in the production of medical equipment, devices, and hospital supplies. Biotech and Pharmaceuticals are similar subsectors as they both engage in R&D to create new drugs, and treatment methods. One trait that separates healthcare from other sectors is its defensive quality when the markets turn sour. This is because people will value their health even if the economy is down.

### Top Performers

The top performers in the healthcare industry (measured by market capitalization) are:

1. Johnson and Johnson, Pharmaceuticals- 363.8 billion
2. UnitedHealth Group, Providers and Services- 256.3 billion
3. Pfizer, Pharmaceuticals- 248.3 billion
4. Merck, Pharmaceuticals- 210 billion
5. Abbot, Pharmaceuticals- 134.8 billion

What subsector a company falls into can be very subjective, as many firms having their own type of competitive advantage or vertical and horizontal integration that spans over many parts of the healthcare industry.

### Key Drivers

The healthcare industry is a forward-looking industry and our key drivers revolve around what is driving the industry now and what will drive growth into the future. Aging populations and per capita spending have been driving continuous, revenues in the healthcare industry. Technology and Research and Development have led to growth opportunities that create new avenues for revenue. While aging populations will continue to grow revenues, it will put more pressure on insurance companies, as younger, healthier adults won't want to pay for increasing healthcare prices. Per capita spending has hurt the individual consumer, however has grown the industry exponentially. Technology opportunities is one of the top way's companies can gain a competitive edge over competitors. Digital health, otherwise known as virtual health, is expected to increase 30% in 2019. Virtual health is an opening to hit the market of people that don't like hospitals in general. Cloud and virtual health increase access and affordability for consumers. AI uses machine learning methods to process unstructured data helping with speed, quality and accuracy. Robotics also is another form of growth opportunity as it is a way to develop safer more sophisticated technology. To make these technologies and forms of medicine, companies are increasing research and development to give them an edge over competitors.

### Risks the Sector Faces

New non-traditional competitors are entering into the healthcare market. This takes market share away from typical competitors in the industry. These new competitors can help some sub-sectors but hurt others. This depends on if they are a substitute of that sector or a compliment. Non-traditional large corporations are offering independent healthcare for employees. Amazon has started an independent healthcare company with JP Morgan Chase and Berkshire Hathaway. They also bought the start up Pillpack to be involved in the

pharmaceutical market. Medical marijuana will disrupt revenues made on drugs that are prescribed for stress, pain, various mental health issues, and seizures. These new competitors will force change, as they are reducing the amount of traditional forms of healthcare people will need and want. We will see a shift from treatment and cure to prevention. Regulation in the healthcare industry plays a big role. January 1st the individual mandate repeal went into effect. This affects the number of people utilizing health care and insurance, reducing healthcare provider and services revenue. There is also uncertainty for the future with the repeal of the ACA. Drug pricing is another big topic in D.C. with constant calls for large pharmaceutical companies to lower their prices. As the health industry becomes more digitized, cybersecurity is becoming a top concern.

### **Growth Opportunities**

Growth opportunities are revolving around the consumer, since healthcare is becoming shoppable, consumers are wanting healthcare to mirror other parts of their lives like choices, convenience and transparent pricing. Also, consumers are dissatisfied with poor service, enhancing the patient experience is a potential area for dramatic change. In the last 5 years, the healthcare industry has turned to mergers, acquisitions and partnerships for growth, however this has led to a dramatic increase in debt which we will keep an eye on.

### **Portfolio**

- Medtronic Plc is the largest medical technology company, which develop, manufacture, distribute, and sell device-based medical therapies and services. They have a low EV/EBITDA compared to competitors. Their Forward Dividend yield is 2.2%, considerably higher than sector and S&P averages. As shown before we see a lot of growth opportunities in the medical tech industry also. We recommend to HOLD.
- UnitedHealth Group, Inc. is a managed health care company that engages in the provision of health care coverage, software, and data consultancy services. They have a solid history of earnings growth with more growth forecasted and they have outperformed their sector considerably. UnitedHealth Group is another company with great dividends. They also have the largest and most diverse membership base in the managed care organization market. its diversification in the high margin healthcare IT services gives it an advantage over competitors. We recommend to HOLD.
- Intuitive Surgical makes robotic products for surgeries. Their goal is to have minimally invasive surgery. The company has seen constant sales growth over the past 5 years. One thing to keep an eye on is debt, because they have doubled their debt load since 2015. Intuitive Surgical does not pay dividends so they are a growth focused stock that has been performing excellently over the past few years. We recommend to HOLD.
- Thermo Fisher Scientific is a biotechnology product development company. They business includes high technology applications include cloning, Cell analysis and synthetic biology. They employ talented personnel that separates them from their competitors. The company is up 20% over the last year, and we recommend to HOLD.
- Pfizer is one of the world's largest pharmaceutical companies, has outperformed the pharmaceutical industry as a whole. They have a strong balance sheet with below average debt. The company has seen dividend growth over the past few years. While many patents are expiring, they have a wide array of new patents hitting the market. We are wary of drug pricing regulation so we recommend a HOLD for now.