

Kieger – Thoughts from the Street

JPM Conference 2017

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Companies signalled confidence in their fundamentals, however, political uncertainties and headline risks remain

We attended the 35th annual J.P. Morgan Healthcare Conference 2017 from January 9th to 12th in San Francisco.

With 467 companies participating (USD 4.3tn in market cap), over 10'000 attendees and over 12'000 organized 1 on 1 meetings, the conference normally sets the tone for the healthcare investment year. Company executives were confident regarding their fundamentals. While uncertainty around the ACA repeal and replacement remains high, the US corporate tax reform could lead to earnings accretion for the sector.

After a turbulent 2016 for healthcare investors, the industry gathered in San Francisco with hope for guidance for a brighter 2017.

While from our point of view company managements emphatically signalled confidence in their product cycles, end markets, growth opportunities and generally in their fundamentals, the political uncertainty remains high. There were two main topics discussed across all presentations and Q&A sessions. Firstly, the impact of a likely Affordable Care Act (ACA) repeal and replacement and secondly, the impact

of a potential US corporate tax reform.

ACA – repeal and replace: Uncertainties remain high

While repealing of the ACA seems relatively easy given the current political majorities through budget reconciliation, a simultaneous replacement of the law is more difficult. This even more so if all promises of the new administration are to be kept (continuation of the popular aspects but reducing the costs). To make matters even more complicated there seems to exist no consensus between the different Republican opinion leaders (Speaker of the House of Representatives Paul Ryan plan vs. next Department of Health and Human Services leader Tom Price ideas vs. President-elect Trump's own proposals and timeline expectations).

Though the question is politically highly relevant, interestingly even the most exposed companies (hospital providers and health insurance companies) seemed not concerned by the current direction of political discussions and tried to assure that they would be able to adjust in any case. We also noticed that in general most executives tried to relativize the past positive impact of the ACA on their businesses.

Based on our conversations at the conference, the most likely of several possible scenarios remains a fast and more symbolic repeal and replacement (enough to declare victory) followed by gradual long-term changes. In any case we expect more clarity during the coming weeks as the new administration starts to work.

US corporate tax reform: Potential for earnings accretion

Executives at the conference highlighted the potential positive impact from a reform of the US corporate tax system. Such a reform could include:

- A change from a worldwide to a territorial system.
- A reduction of the corporate income tax rate from 35% currently, to a level of 15% (Trump plan) to 20% (House Republican plan).
- The possibility to immediately tax expense the cost of equipment; however, the loss of net interest deductions.
- The implementation of a broader adjustment tax (costs of imports are not tax deductible while profits of exports are not taxed).
- The possibility to repatriate foreign cash holdings at a reduced tax rate.

As with the ACA repeal and replace plans details remain limited. Tough not limited to the healthcare sector, depending on each company's tax, revenues and cost structure, the reform could become highly accretive to earnings.

Bottom line: Companies appear confident; high sensitivity to politics

Companies seemed confident in their fundamentals and business prospects. However, the sensitivity of the healthcare stock market to political discussions and headlines remains high. Given the limited information around the Republican repeal and replace plan, executives had difficulties in estimating the potential impact, but seemed not concerned. On the positive side the discussed US corporate tax reform could company specific evolve as an important catalyst for the investment year 2017.

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