KIEGER HEALTHCARE Monthly Commentary

Zurich, 2 November 2022

Much more "treat" than "trick"

The 2022 spooky season is not over yet, but October did bring some sweet relief to markets. Although the situation did not change fundamentally during the month, some weaker macro readings spurred hopes among market participants that central banks might refrain from overtightening and thereby avoid a hard landing. This proved enough to help stocks bounce back from deeply oversold territory. The Q3 earnings season was also an important driver of performance. Healthcare stocks gained 8.4% in October, while global equities rose 7.2%.

Before the first major results were released (more on page 2), Biotechnology stood out performance-wise, boosted by investors' preference for large caps Moderna, Amgen, Genmab, Regeneron, Gilead and Abbvie, all posting high-single-digit to low-double-digit gains. Equipment & Supplies did well too ahead of the reporting season, with Dexcom (CMS expanding the coverage of continuous glucose monitoring devices to Type 2 basal patients) particularly strong. Providers & Services were also positive, CMS' release of Medicare Advantage Star scores (performance and quality score given by the CMS based on its annual consumer surveys) for 2023 being the focus here. While CVS and Centene saw their Star scores decline (implying lower Star bonus payments in 2024), the other major Managed Care Organisations came out ahead. Healthcare Technology excepted, all the other subsectors were pretty much flat until the reporting season began.

At the time of writing, 47% of MSCI World Healthcare components have released their Q3 results. 61% of them outdid sales expectations (for a 1.6% aggregate upside surprise, below the average of the past 8 quarters). EPS-wise, 64% of the firms beat expectations, lower than the 2-year average.

Overall, subsector returns for October stand as follows: Biotechnology +11.2%, Providers & Services +11.1%, Pharmaceuticals +7.9%, Equipment & Supplies +7.8%, Healthcare Technology +5.0% and Life Sciences Tools & Services +4.0%.

In the spotlight

Earnings season

Within Equipment & Supplies, orthopaedic firms saw procedural volumes recover in Q3, although hospital staffing issues and component shortages continued to weigh on the ability to reduce the procedure backlog. With regards to larger hospital system placements, the capex environment seems to be stable. A topic during Q3 was the increased pressure in the high-end, elective procedure, consumer segment. Dental firm Align missed estimates and flagged lower consumer confidence, no-shows and a lesser disposition to finance treatments. Abbvie mentioned the same factors for its consumer-facing, cash-pay aesthetics business. Following the earnings releases, Equipment manufacturers lost -0.7% on average, while Supply names shed -8.7%.

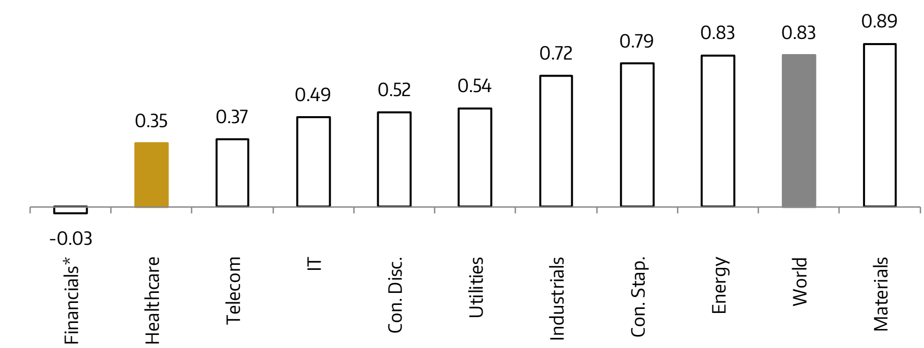
In Providers & Services, managed care companies all outpaced expectations, and provided initial outlooks for 2023 that were also higher than anticipated. Stocks gained 2.1% on the day of earnings release. Hospitals, helped by the ongoing improvement in elective procedures and lower contract labour expenses, reported better-than-expected numbers – with stocks rising 3.7% thereafter. Within Services, laboratories met expectations for their base-testing businesses and the performance of dialysis names was, as in Q2, mixed (firm-specific issues). Overall, stocks suffered a negative price reaction (-8.9%), mainly driven by the LabCorp (firm-specific issues in the CRO business) and DaVita selloffs. As for distributors, only 40% of companies have released their results to date.

For Tools & Services, both sales and earnings surprises were below average. As regards large bioprocessing firms, the transition away from COVID-19 and stocking was a key topic during earnings calls. Despite emphasising that core bioprocessing demand (excluding COVID-19) remains very robust, comments from Sartorius ("normalisation of order intake") and Danaher ("not seeing significant stocking, but we do see pockets of stocking, particularly there where there were large COVID-related either therapeutic or vaccine programs") led to a sell-off in these and other bioprocessing stocks (Thermo Fisher, Merck KGaA). Within instruments, demand remains strong and end markets continue to look healthy. Although it still early days to call it an all-clear, comments from the CROs (Medpace, Iqvia, PPD/Thermo Fisher, Labcorp) pointed to a (still?) intact environment (funding above 5-year average pre-COVID-19 levels, normal number of cancellations, good RFP volumes, ...). Pure-play CRO stocks moved up significantly in the second part of the month.

In Pharma, Q3 results were idiosyncratic, and sales surprises in-line with historical averages. In terms of earnings, positive surprises exceeded the 2-year average. Stocks lost 0.3% on average following the quarterly report.

Biotechnology experienced aggregate sales and earnings surprises that matched the historical average. Stocks traded almost flat in the aftermath of publication (-0.5%).

Chart of the Month: Correlation between global GDP growth and sector revenue growth (1996-2021)



Source: MSCI, Kieger

Over the past 26 years Healthcare is the sector that has experienced the lowest correlation between the growth of its revenues and that of global GDP. While other sectors' sales growth is simply a function of GDP growth, Healthcare has unique drivers that make it possible for growth to continue even in difficult environments. The most important of these drivers are ageing demographics, a rising middle class in emerging markets, lifestyle changes and a high level of innovation. Check out our video on this subject on: https://kieger.com/news/kieger-healthcare-chart-of-the-month-14/

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