



Summary

Overhang in Healthcare removed with Reform Bill

On Sunday, the US House of Representatives passed the US Health Care Reform Bill, and the response of the market was a broad rally in Healthcare stocks. The Healthcare sector had underperformed the wider market in 2009 because of the uncertainty over the reforms. The Reform Bill is more modest than what the market feared and the impact on the earnings of the healthcare sector is less than what the market has priced.

This removal of headline risk and the increase in clarity should benefit Healthcare stocks in the months ahead. Valuations of the Healthcare sector are at 20-year lows. The sector is also under-owned as uncertainty over the reforms has kept investors on the sidelines.

We continue to be positive on the long term outlook for the Healthcare sector. The demand for Healthcare will continue to rise as the populations in the Developed Economies are ageing while those in the Emerging Markets are becoming more affluent. There are also still significant unmet needs in Healthcare and the truly innovative companies will continue to be rewarded.

Clarity on reforms removes overhang

On Sunday, the US House of Representatives passed the US Health Care Reform Bill, The Bill has now gone to the US Senate and while there may be amendments or efforts to derail the Bill, it appears likely that the Bill will be passed.

The response of the market to the Bill's passing at the House of Representatives was a broad rally in Healthcare stocks. The Healthcare sector had underperformed the wider market in 2009 because of the uncertainty over the reforms. The Reform Bill is more modest than what the market feared and the impact on the earnings of the healthcare sector is less than what the market has priced. One key concern was the potential introduction of a government health insurance plan to compete with the private sector but this option is not in the final Bill. Another concern was the possibility of federal oversight of health insurance rates and premiums, which would have meant control on prices. This too was not included.

Impact on the various sub-sectors

The impact on **Health Insurance** companies is mixed. A key feature of the Reform is the extension of health insurance coverage to 32 millions uninsured Americans. Under the Bill, almost every American will be required to purchase health insurance or face a US\$695 annual fine. There are some exceptions for low-income people. From 2014, employers with 50 or more workers must provide health insurance or otherwise be fined.

However, the increase in total insurance premiums from 32 million new people is balanced by new obligations for the insurance companies. Under the reforms, insurance companies can no longer deny coverage to children based on existing pre-conditions nor cancel policies if an insured person falls ill. From 2014, insurance companies cannot deny coverage to anyone with pre-existing conditions.

The **Pharmaceutical** and **Biotech** Industries appear to be winners. Drug companies will have to contribute to an estimated US\$90 billion in rebates and fees over the next 10 years but this is balanced by them winning 12 years of protection against generic competition for biotech drugs, their higher earning business. The increase of 32 million people with insurance coverage will also lead to a higher volume of drugs purchased.

In general, the extension of health insurance to 32 million more people will mean a volume increase for most of the sub-sectors. Apart from the Insurance companies and Pharmaceutical companies, the other sectors which stand to benefit are the Generic companies, Drug Distributors and Hospitals.

Attractive valuations and under-owned

This removal of headline risk and the increase in clarity should benefit Healthcare stocks in the months ahead. Valuations of the Healthcare sector are at 20-year lows. The sector is also under-owned as uncertainty over the reforms has kept investors on the sidelines.

We continue to be positive on the long term outlook for the Healthcare sector. The demand for Healthcare will continue to rise as the populations in the Developed Economies are ageing while those in the Emerging Markets are becoming more affluent. There are also still significant unmet needs in Healthcare and the truly innovative companies will continue to be rewarded.



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