

Silverhorn Perspective



Healthcare: China's new nexus

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Large population plus an infrastructure in need of an update equal bright time for investment.

With China's current healthcare capacity unlikely to be able to serve all the growing medical care needs of the country, the scene is set for technological innovation and frontier medical treatments to fill this ever-expanding supply-demand gap. Triggered and accelerated by the COVID-19 pandemic, the Chinese government is furthering healthcare reforms by focusing on expanding access to quality healthcare across the country, innovative medical technology adoption, and nationwide healthcare system digitalisation.

China's healthcare sector was overshadowed by the rapid rise of tech giants for most of 2000s. However, today, the healthcare industry is coming into the spotlight. Names like Wuxi Biologics and Ping An Healthcare have a fraction of the online giants' market cap. A confluence of factors all but assure that they will get much bigger.



Ping An Healthcare is the largest online medical service platform in China.
Ping An Insurance, one of the major insurers in China, owns 38.4% of its shares.

Supply-side factors that are creating huge tailwinds for the Chinese healthcare sector are:

- 1. Talent:** China's talent pool is still smaller than the US, but it is rapidly expanding as local talent continues to develop and Western-trained scientists steadily return to China. A 2008 study¹ found that between 1978 and 2007, more than 1.2mn Chinese practitioners went abroad to study or work but only about 25% returned in that period. In the following decade, however, the rate of returnees jumped to 80% according to the latest study². China currently produces 10k domestic life sciences PHDs per year and 3k life sciences PHDs of Chinese origin from the US per year. According to BCG, more than 75% of the top talent in China has at least five years of overseas research experience. Returnees, who are often referred to as "sea turtles" locally, have been the key driver behind the formation of innovative companies in China over the past ten years. While the government has actively encouraged their return, the attractive market dynamics have already superseded government initiatives. This dynamic continues to be a huge tailwind for the Chinese healthcare sector.
- 2. Science and Know-how:** China's ranking on the Global Innovation Index has moved up rapidly over the past few years with its scientific and technological development becoming a more prominent force globally, including in medicine and life sciences. Last year, China made significant breakthroughs in drug research and development. Of the 39 major achievements in medicine, seven were related to pharmaceutical research and development. The most notable achievement to date is the development of a new drug called GV-971. This is the first new drug approved for Alzheimer's disease in the world since 2003. In November 2021, the US FDA approved Zanubrutinib, a drug by a Chinese company used to treat adult patients with a rare form of cancer.



Developer of Zanubrutinib: BeiGene, a biotechnology company in China

This was the first time an innovative drug developed in China entered the US market. Industry experts expect more similar new drug launches³.

The medical industry in China has entered the AI and big data era in a big way. From 2015 to 2019, a total of 25,717 scientific publications related to the topic of health AI were published globally. And China ranked amongst the top 5 countries with the highest scholarly output including the US, India, the UK, and Germany. Since 2017, the number of clinical trials related to AI has increased rapidly globally with China and the US accounting for the most. In September 2020, China became the country with the largest number of AI-related clinical trials in the world. This is proof that China is quickly catching-up to the US and when it comes to AI and big data (which is becoming increasingly relevant for healthcare), China is already one of the leading AI players with considerable influence⁴.

¹ ["China's brain drain at the high end"](#) published in Asian Population Studies Journal on 21 November 2008

² ["Returning scientists and the emergence of China's science system"](#) published in Science and Public Policy Journal on 5 December 2019

³ ["Research Breakthroughs Produce New Medicines"](#) published in Chinese Academy of Sciences News Room on 15 January 2020

⁴ ["Report on China's AI Health 2020"](#) published by Elsevier and Peking University Health Science Center in 2020

- Capital:** In 2021, the biotech and life sciences industries led the market in the number of IPOs. 36 companies became listed on the Hong Kong Stock Exchange (HKEX), raising a total of USD 11bn. The HKEX continues to improve the listing rules to meet the development and changes in technology and the market. It recently implemented new rules for special purpose acquisition companies (SPACs). The De-SPAC transactions will provide an alternative route to market for eligible companies from the region or beyond, and an alternative exit option for investors' portfolio companies, in addition to a merger and acquisition deal or a traditional IPO⁵. As a result, more innovative companies are expected to get listed on HKEX as Hong Kong is the world's second-largest biotech IPO centre for local and cross-border listings⁶. Benefitting from ongoing government support and the relaxation in listing of pre-profit biotech companies, healthcare IPOs are expected to become one of the driving forces of the mainland capital markets⁷.

Total funds raised from healthcare/life science listings in the A-shares market reached RMB 85bn, representing 15% of total funds raised in 2021.

- Mainland China and Hong Kong IPO market: 2021 review and 2022 outlook by KPMG

- Policy:** The Chinese healthcare sector has been subject to a very comprehensive and detailed set of regulatory reforms for many years. Each year since 2009, the government has published an annual list of Key Priorities for Healthcare Reform that addresses specific policy objectives for virtually every vertical within healthcare, including hospital oversight, physician behaviour, drug distribution, payment schemes, research and clinical development, and many other areas. Furthermore, the most authoritative governmental agencies have consistently communicated a strategic roadmap for the national healthcare agenda, including in the recent 14th 5-Year Plan as well as the Long-Range Objectives Through the Year 2035. Because improving the healthcare system is important to the government, we remain cautiously optimistic about the impact of policies on the innovative companies within the healthcare sector.

Demand side factors that are creating huge tailwinds for the Chinese healthcare sector are:

- Ageing Population:** Any change in demographics affect a country's economic performance and social development. China is growing old at an astonishingly rapid pace. The share of old-age population is expected to double from 12.6% now to 26% in 2050, with total population likely to peak in the late 2020s and decline subsequently. An aging population and surge in chronic diseases, coupled with higher personal incomes mean greater demand for more and better healthcare.
- Increased Per Capita Spending:** In 2000, the government committed to universalise affiliation to public health insurance schemes through both individual contributions and budget transfers in the priority for health in public spending. This spending has more than doubled as a percentage of GDP. And given the country's rapid economic growth, there has been an increase of ~8-9x in real per capita public spending on health resulting in a 5.3% share of GDP. It is probable that given the rise of the older population, China's expenditure on health could increase further to reach 7-10% levels in the next decade. In which case, the total spend on healthcare in China would reach USD 1.7tn, implying a growth rate of 9.3% per annum until 2028⁸.

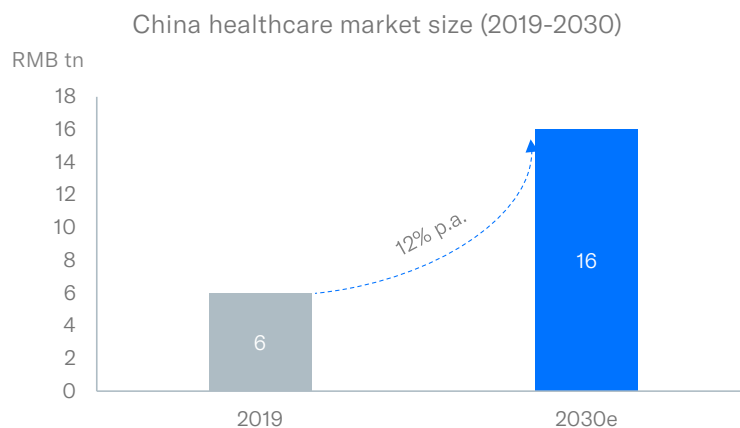
⁵ ["What to Expect as the HKEx Rolls Out Its New SPAC Listing Regime"](#) published in Lexology on 6 January 2022

⁶ ["Number of A-share IPOs and amount of funds raised hit record high, unicorn and return of China concept stocks lift proceeds in Hong Kong"](#) by EY on 21 December 2021

⁷ ["Mainland China and Hong Kong IPO market: 2021 review and 2022 outlook"](#) by KPMG on 9 December 2021

⁸ ["The Growing Demand for Healthcare in China"](#) published by Global Demographics Health in June 2021

Today, the healthcare market in China is the world's second-largest, closely behind the US. But it is the fastest-growing and is expected to overtake the US in the future. McKinsey has projected China's healthcare market to grow at an unprecedented CAGR of about 12% and reach RMB 16tn in size by 2030⁹. We expect the growth to be broad-based because the tailwinds can help virtually every sub-sector, from pharmaceuticals to medical devices to telehealth.



Source: McKinsey

How to best exploit this opportunity?

As always, we work with specialist fund managers. Healthcare investing requires a rare combination of understanding of: the complex regulatory environment, the complex science behind drugs, new form of treatments, medical devices, etc., and capital markets.

In the case of healthcare, we believe a long-short equity approach, albeit with a long bias, makes the most sense to exploit this opportunity. This is because historically the China healthcare market has exhibited the highest intra-sector performance dispersion among other sectors, leading to more pronounced valuation discrepancies and possibility of losses. Because the sub-sectors – pharma, biotech, medtech, etc. – follow different cycles, the performance dispersion is inevitable. This provides a market setup that is conducive for alpha generation. While the long book helps in capturing the structural growth of the sector, the short book helps in smoothening the ride and protecting the downside during inevitable bust cycles. This will help us in compounding patiently and at a high rate over the years to come.

⁹ [“China's healthcare market is expected to grow from RMB6 trillion in 2019 to RMB16 trillion in 2030”](#) by Ping An on 30 April 2021

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