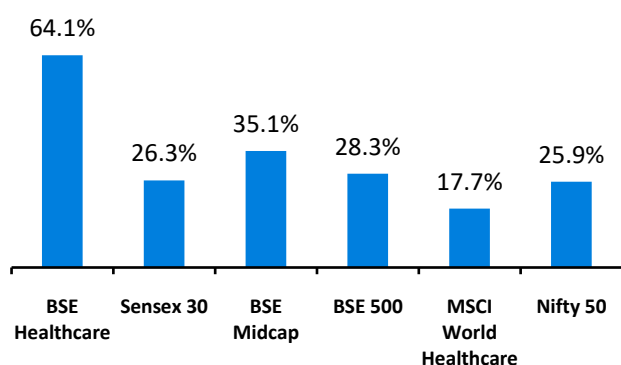


# India Healthcare / life-sciences Sector Rising from COVID Blues

The ongoing pandemic has brought to centre-stage the attention for healthcare and life-sciences sector as a central investing theme for the present decade. The COVID legacy has already resulted in record USD2.7 Bn private capital inflow in the sector in 2020. The listed pharma and healthcare universe too has seen tremendous investor interest with the BSE HC index having significantly outperformed the broader indices since the start of the COVID outbreak in early 2020. During this period (Jan 2020 till Feb2021), the BSE Healthcare index was up 64% vs. Sensex at 26%. Another reflection of positive investor sentiment is seen from Forward P/E valuation of NSE Pharma index which has traded consistently at a premium to the P/E of the broader Nifty 50 index. This heightened investor interest is largely in anticipation of the sector showing earnings resilience compared to other sectors of the economy and investor preference for defensive plays during present turbulent times.

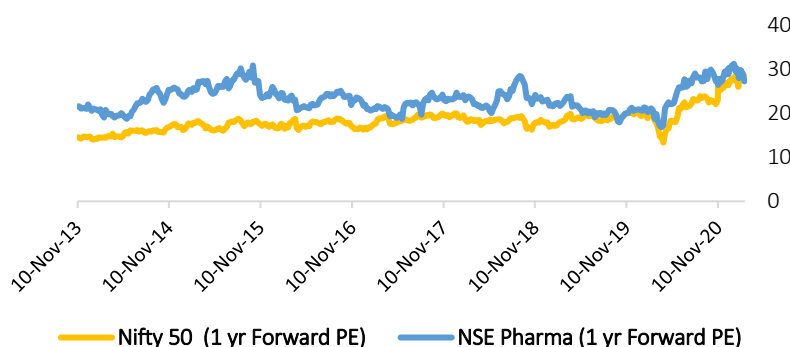
While there is little doubt that the overall sector has seen heightened investor activity, a deep-dive into the financial and valuation performance of the five sub-segments in the listed universe has some key take-aways: 1. All the five segments of the sector have demonstrated recovery over two quarters, a key indication of the overall sector having shrugged off COVID impact quite well. 2. Within Pharmas, the 'Big Pharma' margin and valuation resilience continues while mid-cap pharma has seen a sharp valuation come-back in the past quarter backed by performance. 3. Within healthcare services, both delivery and diagnostic services have shown a modest earnings come-back in the past quarter; however investor interest in diagnostic services remain at all-time high. 4. Manufacturing plays in pharma have grabbed the spotlight in terms of both earnings and valuation premium. Detail analysis follows..

**BSE Healthcare Index vs Other Indices (Jan'20 – Feb'21)**



Source: BSE, NSE and Investing.com

**Nifty 50 P/E vs NSE Pharma P/E comparison (1 yr Fwd)**



Source: Venture Intelligence

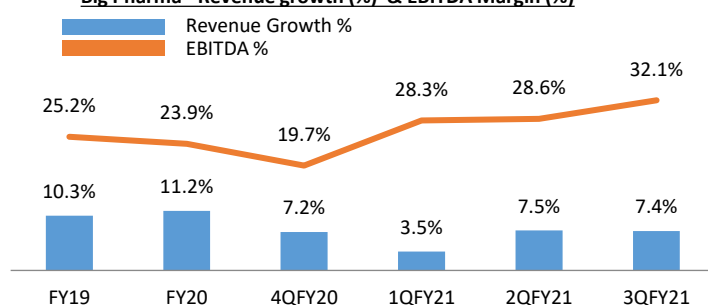
# A Look at Sub-Sector Financial & Valuation Impact of COVID

## 1. Big pharma margin and valuation resilience continues through 2Q and 3Q

A large part of the listed sector significant stock outperformance in YTD2020 has been on account of the 'Big Pharma' segment which form over 2/3rds of the universe (in terms of market cap). Here, the investor interest is a reflection of this segment being well shielded from Covid impact compared to small pharma. Most of them have comfortable balance sheet positions, currency benefit and are better geared to address business discontinuity.

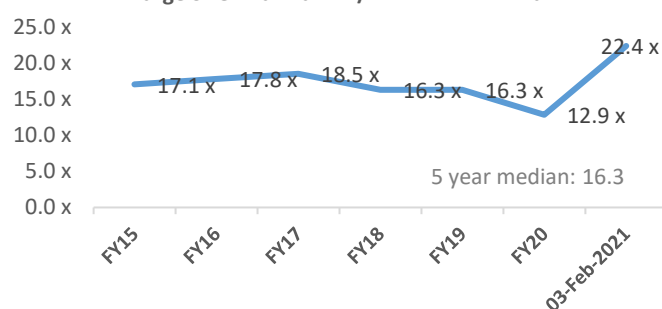
An analysis of this segment's financial performance over last three quarters indicates an improving positive growth surge despite massive economic turbulence on account of the pandemic. This is a reflection of the fact that most big pharma have managed to restart manufacturing activity within a few weeks of the lockdown despite initial disruption. This segment has also managed the supply chain disruptions far more efficiently than the small and mid-size pharma. The most impressive aspect of this segment has been the good margin uptick during the COVID period which is largely reflective of a nimble cost rationalization measures. This also explains the valuation premium for this segment which is presently trading at significant premium to long-term median valuation in terms of EV/EBITDA metrics.

**Big Pharma - Revenue growth (%) & EBITDA Margin (%)**



Source: Duff & Phelps

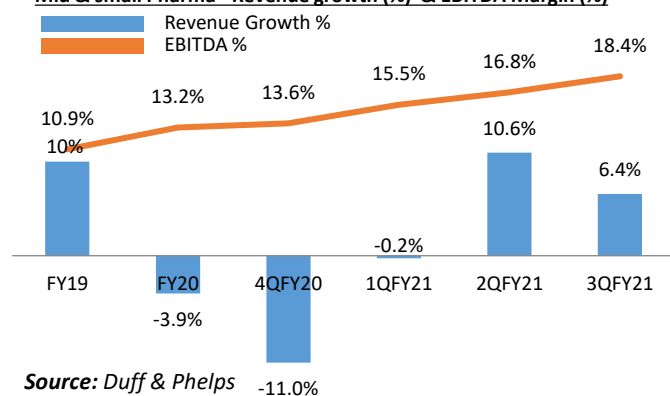
**Large Size Pharma - EV/EBITDA - 1 Yr Fwd**



## 2. Significant performance and valuation come-back in mid-size pharma

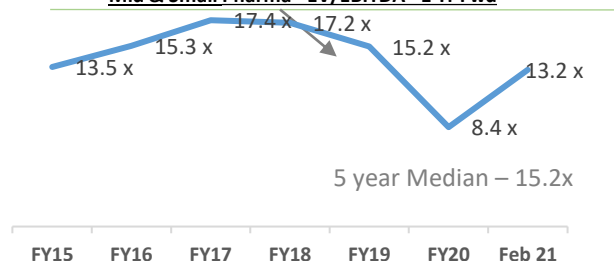
After a prolonged six quarter de-growth since the start of FY20, the small and mid-sized listed pharma have registered a sharp bounce-back of growth in the last two quarters. From a valuation standpoint too, this segment has seen a significant pick-up compared from its earlier sharp discount to the 5-year median valuation range. For the last six quarters this basket of stocks were reflective of the business uncertainties and vulnerable balance sheet positions especially to deal with the present crisis. The sharp pick-up in growth a valuation in 2Q and 3Q is clearly an optimistic trend to watch out for.

**Mid & small Pharma - Revenue growth (%) & EBITDA Margin (%)**



Source: Duff & Phelps

**Mid & Small Pharma - EV/EBITDA - 1 Yr Fwd**

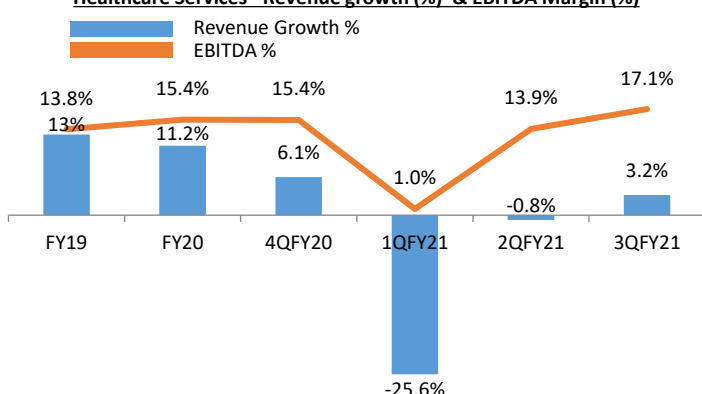


Source: Duff & Phelps

### 3. Healthcare Services too now stable after severe COVID brunt

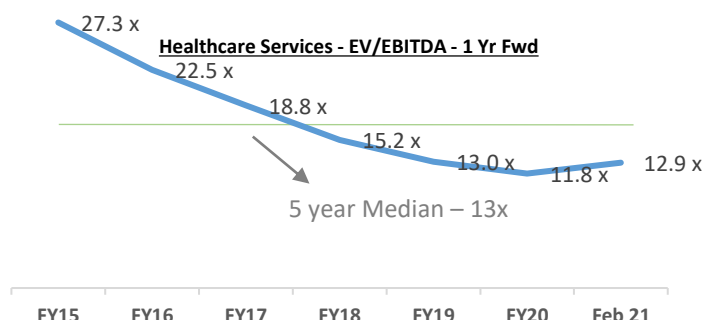
The listed healthcare services stocks are presently trading near historical lows in terms of both multiples on Revenue and EBITDA. More importantly, the significant sell-off during the last 8 months of COVID lock-down reflects the drop in volumes for most healthcare specialties especially the elective procedures like ortho, eye-care etc. While during 1QFY21, the listed healthcare services segment has registered over 25% YoY de-growth in revenues the 2QFY21 bounce-back to flat YoY revenues is a promising come-back for this segment. Further, given the participation of most of the hospitals in the treatment of Covid-19 patients this has also impacted the sector's margin which has crashed to near zero levels during the COVID period. We expect the recent stable revenue trend to continue in the coming quarters. Stock prices and valuations seem to be factoring the concern on growth and margin profile which explains the reason for this sector trading at discount to their 5-year median valuation.

**Healthcare Services - Revenue growth (%) & EBITDA Margin (%)**



Source: Duff & Phelps

**Healthcare Services - EV/EBITDA - 1 Yr Fwd**

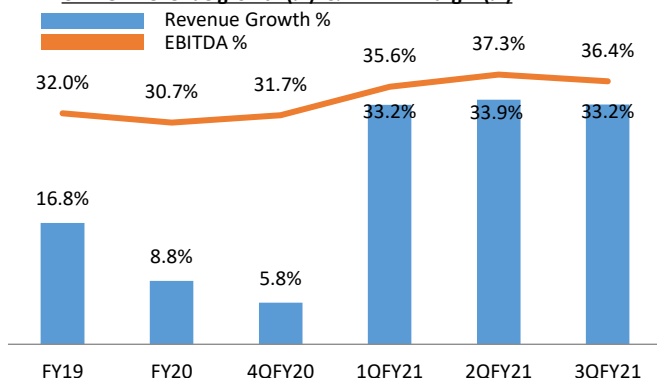


Source: Duff & Phelps

### 3. Pharma manufacturing services retains the spotlight on performance

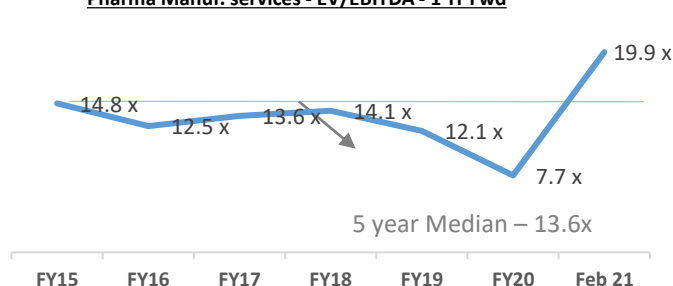
The specialized segment of pharma manufacturing services accounts for about 10% of the listed sector universe. Valuations in this segment have reached 5 year high even during the present crisis. This segment presently trades at significant 38% premium to 5-year median value in terms of EBITDA multiples. This is a reflection of the continuing positive investor sentiment in pharma manufacturing activity which has further strengthened during the Covid period on account of restriction from Chinese pharma imports among other company specific factors. During the 1Q and 2QFY21 quarters, this segment has delivered record 30%+ YoY revenue growth combined with impressive 30%+ EBITDA margins. This segment is clearly at its fundamental best despite pandemic times.

**CDMO - Revenue growth (%) & EBITDA Margin (%)**



Source: Duff & Phelps

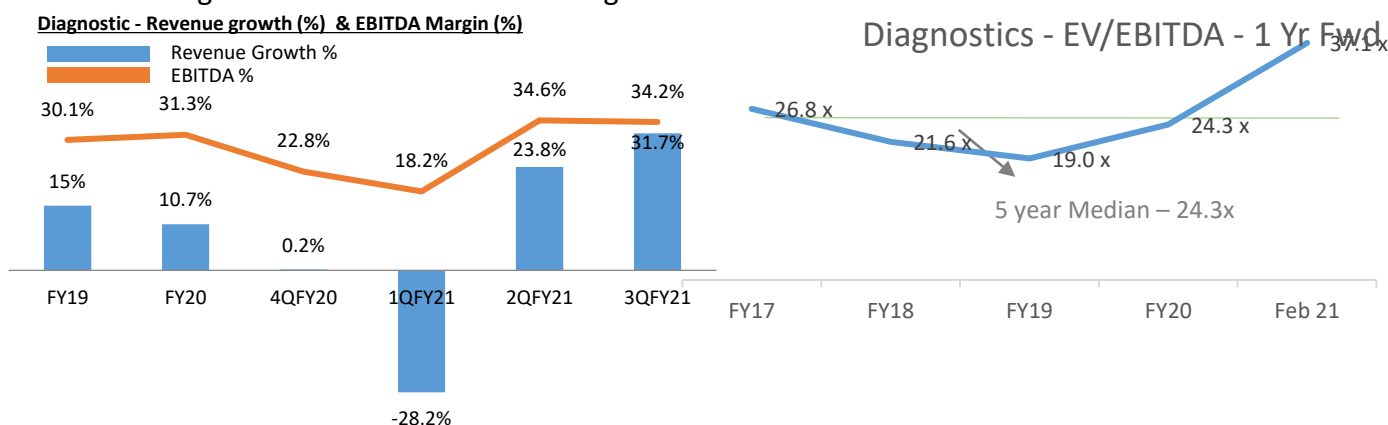
**Pharma Manuf. services - EV/EBITDA - 1 Yr Fwd**



Source: Duff & Phelps

## 5. Sharp come-back for Diagnostic plays; valuations get more expensive

Diagnostic companies have seen their business dynamics change due to social distancing norms. Compared to pre-COVID times where footfalls from walk-ins used to constitute bulk of volumes, the initial lockdown months have disrupted the business due to drying up of business from walk-ins. This is also corroborated by the sharp 28% revenue de-growth for the segment during the 1Q FY21 quarter. However 2QFY21 has witnessed a sharp surge in volumes and initial indications are that the segment has now bounced back better than the pre-covid levels. This segment is now gearing up to driving volumes from home collections and digital offerings. Given the general expectation of likely normalization of operations in the coming months, the valuation of this set remain high and resilient. This set is presently trading at significant premium to their long term median valuation range in terms of EBITDA multiples. This is also on account of scarcity factor combined with low weightage in the listed universe offering. Several of these players are also augmenting digital offerings and have beefed up PPP models to integrate with the Govt. for COVID tests. From a long term perspective, the increasing cost of doing business may lead to margin contraction especially for smaller players giving way to the much needed industry consolidation which will also have a bearing on valuations for this small segment.



Source: Duff & Phelps

Source: Duff & Phelps

## 6. Private capital Investor preference at contrast to the listed counterparts

A look at select recent transactions in the private capital space has revealed investor appetite in sub-segments like pharma services and healthcare services. The transaction valuations (in terms of EBITDA multiples) in these two segments while attracting private capital have ranged at 15-18% premium comparable in the listed segment.

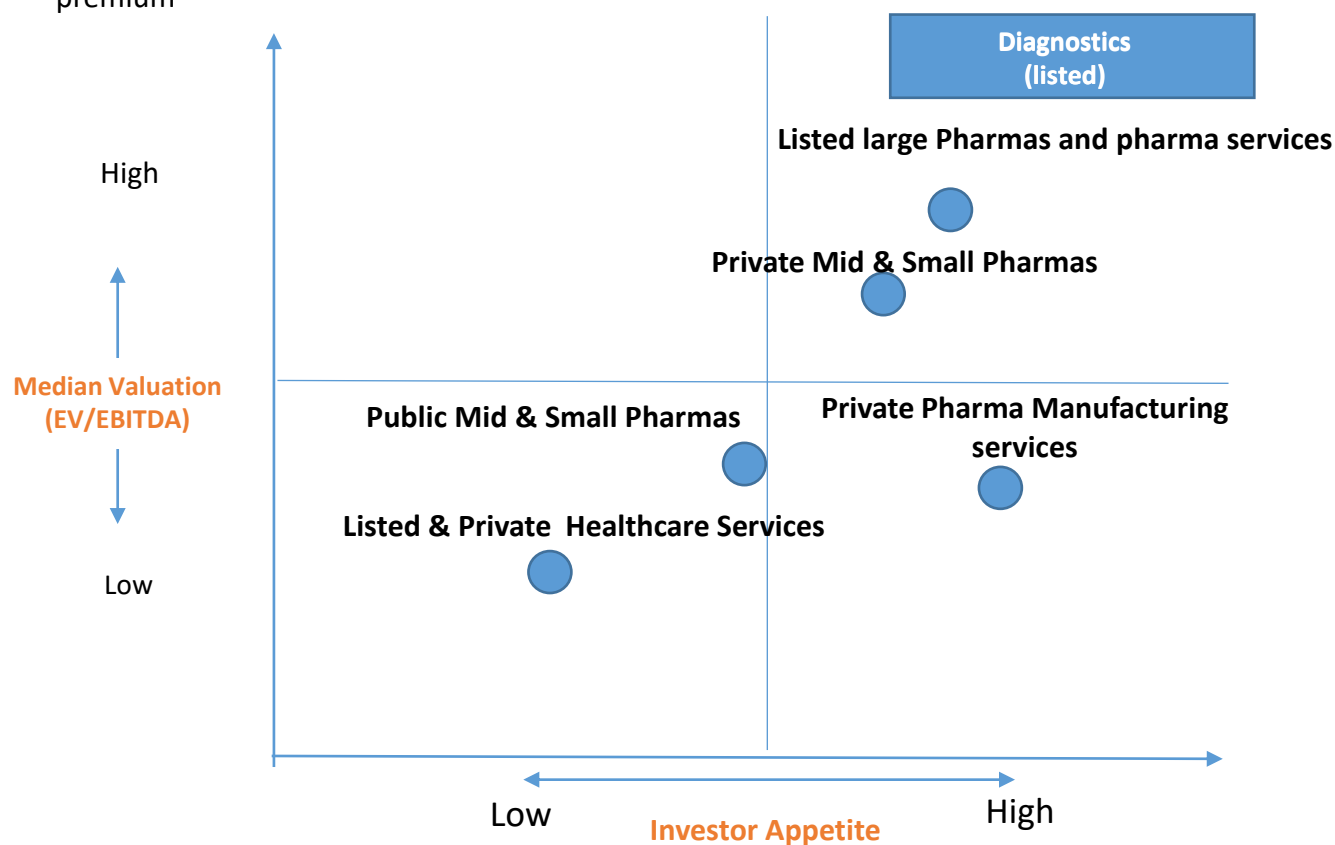
VALUATION COMPARISON	Median EV/EBITDA multiples (5 year)	Current EV/EBITDA multiples (Listed Entities)	Listed Valuation Premium/Discount to 5yr Median (%)
Large pharma	16.3	22.4	+37%
Small and medium pharma	15.2	13.2	-13%
Diagnostics	24.3	37.1	+53%
CDMO/pharma services	13.6	19.9	+46%
Healthcare services	13	12.9	-0%

Source: Venture Intelligence database

## Key Conclusions

In conclusion, the sector on an overall basis seems to be fairly well insulated from most types of economic vagaries including an economic black swan event like the present crisis. Another key take-away is that even within the sector, there is significant polarisation in terms of investor preference for select sub-segments as well as preference for sizeable plays. A detailed dissection of the five key sub-sectors of the listed universe and their private market comparable provide long-term valuation insights and investor preferences even within the sector. Some key take-aways are:

- Public market investors have preferred to back size over discounted valuations
- All the five segments of the sector have demonstrated recovery over two quarters, a key indication of the overall sector having shrugged off COVID impact quite well.
- Within Pharmas, the 'Big Pharma' margin and valuation resilience continues while mid-cap pharma has seen a sharp valuation come-back in the past quarter backed by performance. Valuations of 'Big Pharma' have retained their financial stronghold even during the present turbulent times and are presently trending at significant premium to their 5-year median value. This is clearly a reflection of Investors rewarding size and earnings resilience which this segment adequately demonstrates.
- Within healthcare services, both delivery and diagnostic services have shown a modest earnings come-back in the past quarter; however investor interest in diagnostic services remain at all-time high reflecting the growth opportunity arising from present turbulent times.
- Manufacturing plays in pharma have grabbed the spotlight in terms of both earnings and valuation premium



Source: TCHF analysis

Note -

- Total sample – 239 (listed companies) & c.30 (private market transactions)
- Listed Large Pharma defined as > INR 5000 Cr Enterprise value
- Listed Mid and Small Pharma as < INR 5000 Cr Enterprise value
- Valuation criteria taken into consideration is EV/ EBITDA and includes most recent historical and actual financials

This thematic has been conceptualized and written by the investment team at Tata Capital Healthcare Fund (TCHF), a growth oriented private equity fund primarily focused on the healthcare and life Sciences sector in India. The investment team of TCHF can be contacted at [info.tchf@tatacapital.com](mailto:info.tchf@tatacapital.com).