TATA CAPITAL

Healthcare Fund

India Listed Pharma and Healthcare

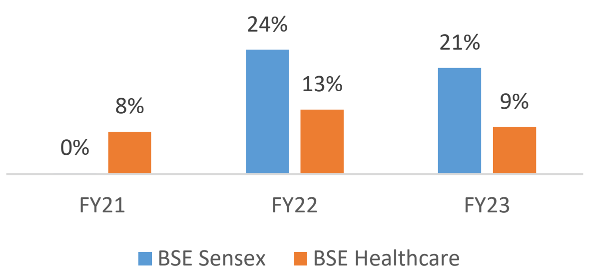
India Healthcare / life-sciences
Taking Stock: Financial and Valuation Insights

Until FY21, India's healthcare and life-sciences listed universe has historically outperformed the broader market indices across longer time periods (say 3Yr, 5Yr and 10Yr). However, over the last two years (FY22, FY23) we have witnessed significant sector underperformance compared to the benchmark market index. A lot of this can be explained by taking stock of the sector's fundamentals. It is observed that compared to an average two revenue growth of 22% for broader market universe, the healthcare listed universe revenue growth is a meagre 11% which is a good 50% underperformance to market. If we were to look at earnings performance for the sector's listed set, last two year average EPS growth for the sector stands at 5.5% vs the market average EPS growth of 26.5%. This in a way is a key reason for the listed sectors' significant lower investor interest in the last two years.

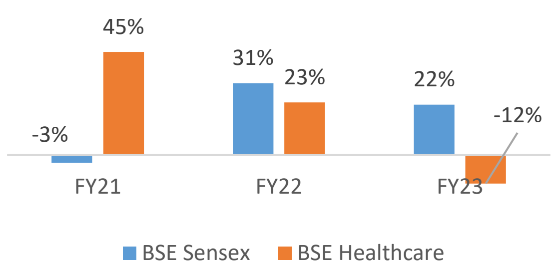
In sharp contrast to the listed universe, the sector's private capital investor interest has been at a peak over the last two years. The private healthcare sector has attracted ~ US$11.5Bn capital in the last two years, which is highest ever 2 year period in the past decade. The private healthcare sector also ranks amount top-3 sectors in terms of both deal value and deal volume in the past decade.

A deeper analysis of the financial and valuation trends of the five core subsegments of the listed healthcare sector throws interesting trends. We also compare the same with the private capital set for the sector.

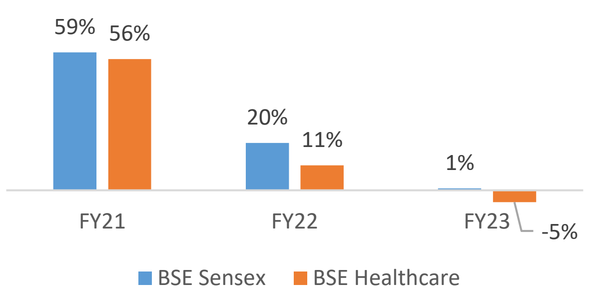
BSE Sensex vs BSE Healthcare Index – Revenue Growth



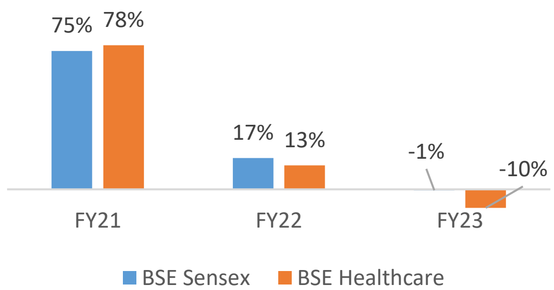
BSE Sensex vs BSE Healthcare Index – EPS Growth



BSE Sensex vs BSE Healthcare Index – Market Cap growth



BSE Sensex vs BSE Healthcare Index - Returns



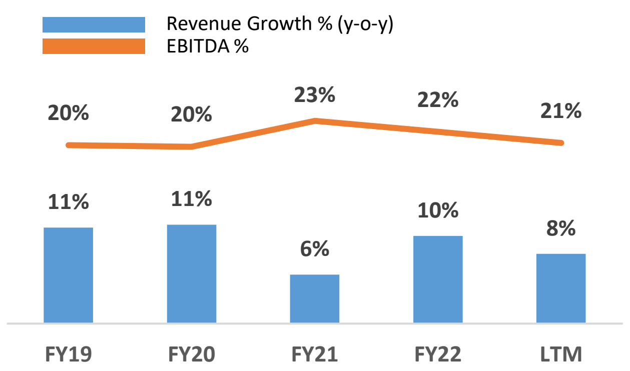
Source: *BSE, Capital IQ, TCHF Analysis*

A Look at Sub-Sector Financial & Valuation Trends

1. Large Pharma: Stable plays but shadowed by US generic headwinds

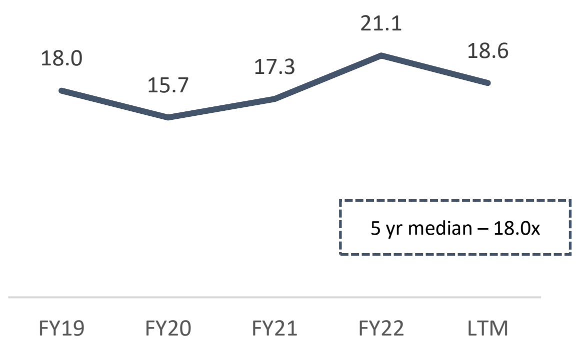
The large pharma segment has witnessed a tad weaker revenue growth at 8% for the LTM Dec FY23 period compared to its historical average of 10%. EBITDA margin for this segment remains stable at 21%. One of the big factors to consider is the significant dependence on US generics market which has been in a long-term declining trend due to price corrections and supply chain consolidation. However, there may well be a structural bounce-back in the US generics macro environment going forward given several players exits, consolidation among existing players and the current level of peak drug shortage. The increased regulatory scrutiny on several US generic focused companies continues to weigh on the sectors fundamentals which presently trades at median EV/EBITDA of 18.6x which is higher than its historical median. We expect the sub-segment to continue to be a haven for investors given its track record of delivering consistent returns over the long term.

Large Size Pharma – Revenue growth (%) & EBITDA Margin (%)



Source: *TCHF Analysis, Capital IQ*

Large Size Pharma – Median EV/EBITDA

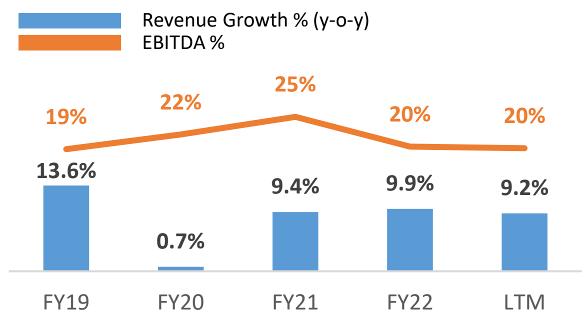


Source: *TCHF Analysis, CapIQ*

2. Mid-size pharma remains a diverse set attracting public investor interest

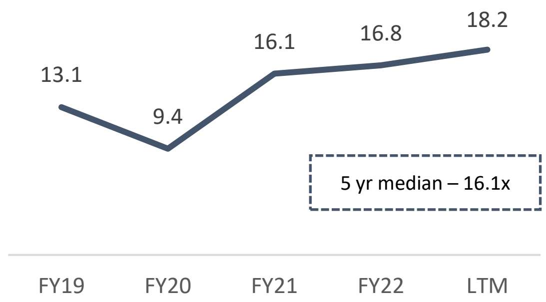
This mid-size pharma segment is a mixed bag with companies across APIs, domestic formulations and export focused companies. After a turbulent FY20, the small and mid-sized listed pharma have come out of the business uncertainties and supply chain bottlenecks. In LTM Dec FY23, this segment has registered a stable 9%+ YoY revenue growth, in line with last few years and an attractive 20% EBITDA margin. From a valuation standpoint, this segment presently trades at median EBITDA multiple at 18.2x, which is 5 year high and reflects the diverse profile of companies attracting investor interest.

Mid Size Pharma – Revenue growth (%) & EBITDA Margin (%)



Source: *TCHF Analysis, Capital IQ*

Mid Size Pharma – EV/EBITDA

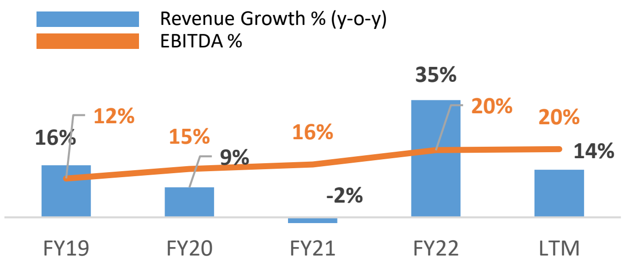


Source: *TCHF Analysis, Capital IQ*

3. Healthcare Delivery segment is now high on investor wish list

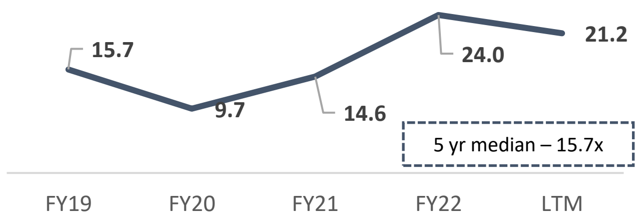
The healthcare delivery sub-segment has seen robust growth since the pandemic (FY22: 35% and LTM Dec FY23 at 14%). The EBITDA margin in the sub-segment at 20% have been the highest over the past 5 years. The tailwinds for the segment such as growing burden of chronic diseases, increased awareness and demand for high quality healthcare with rising affordability of the population continue to be strong. Large established hospitals like HCG, Aster DM, Narayana, KIMS are delivering 15%+ revenue growth with double digit EBITDA margins. The management teams at the large hospitals are looking to grow both organically (For example INR3,000 crore plan by Apollo & INR 2,400 crore plan by Max in next 3 years) and inorganically (for example Narayana Hrudalaya acquiring Shiva Orthopaedic Centre; Apollo acquiring majority stake in AYURVed). The private market in this sub-segment is also buoyant with large transactions such as Manipal Hospitals acquisition by Temasek, Blackstone's impending acquisition of Care Hospitals. We have also seen a few private equity backed regional speciality chains on the path to becoming national chains. The recent strong performance of the sub-segment has attracted investors leading to a re-rating of valuations. (Current EV/EBITDA multiple 21.2x vs. 5-yr median at 15.7x). Overall, the healthcare delivery segment has the potential to continue growing at 12%-15% annually.

Healthcare Delivery – Revenue growth (%) & EBITDA Margin (%)



Source: *TCHF Analysis, Capital IQ*

Healthcare Delivery – EV/EBITDA

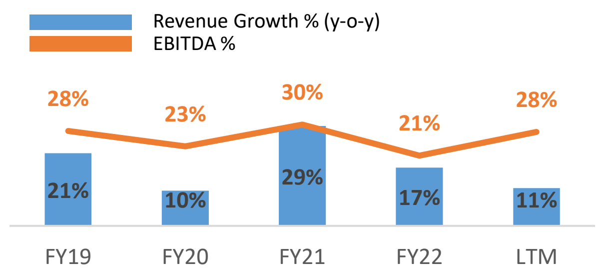


Source: *TCHF Analysis, Capital IQ*

4. Pharma manufacturing services has come off the peak performance

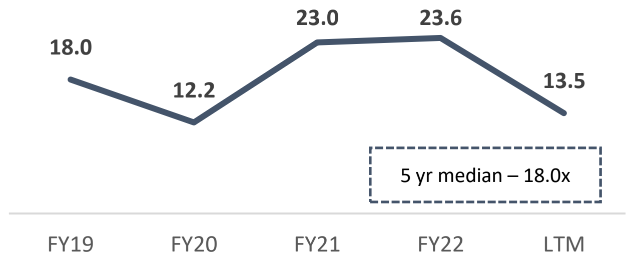
The pharma manufacturing universe largely comprising the five large companies (example Divis, Laurus) has registered lower than historical revenue growth of 11% for LTM Dec FY23. While this muted revenue growth has been largely due to Divi's, the rest of the pack have delivered in-line industry growth. This segment continues to register high EBITDA margin at 28% in LTM Dec FY23 mainly due to specialized product and manufacturing capabilities of select players like Divis. This segment presently trades at 13.5x EV/EBITDA multiple which is significantly lower than 23.6x EV/EBITDA multiple observed in FY22; this is primarily attributed to the significant stock correction in Laurus Labs and Windlass Biotech given recent performance disappointment. The long-term fundamentals of the segment remain strong with continued outsourcing of manufacturing by large and mid-size pharma companies both in India and abroad. Valuations of this segment could well move up to the historical median.

Pharma Manufacturing – Revenue growth (%) & EBITDA Margin (%)



Source: *TCHF Analysis, Capital IQ*

Pharma Manufacturing – EV/EBITDA

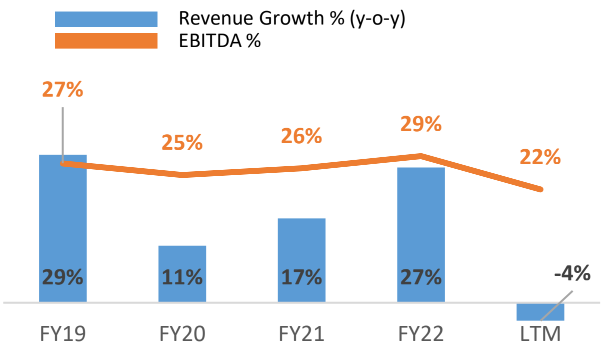


Source: *TCHF Analysis, Capital IQ*

5. Diagnostic services segment performance hit a historic low in FY23

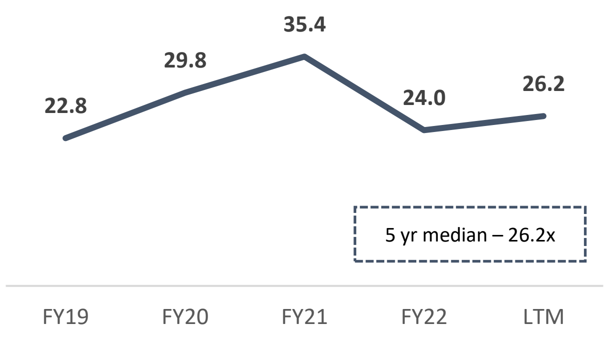
The diagnostic listed segment mainly comprises the five largest players - Dr Lal's, Metropolis, Thyrocare, Vijaya and Krsnaa. For LTM Dec FY23 the listed diagnostic segment registered a revenue decline compared to robust 25%+ revenue growth in the previous year. EBITDA margin too came in significantly lower. A large part of the performance drop can be attributed to the high base effect of the previous two years which were fueled by the pandemic. Added to this is the lower than anticipated growth from acquisitions (e.g. Dr Lal's/Suburban, Metropolis/Hi-tech) and increased competitive intensity with pharma companies and new age players who entered this lucrative market backed by a rush of private capital. Most new entrants focused on opportunities in the routine chronic testing space and bundling test through packages (Wellness) at disruptive pricing. However, with the drying up of private capital funding, the traditional players with strong balance sheets in this segment are expected to benefit. Given the significant unmet need, this segment has the potential to deliver a robust 15%+ growth, we also expect to see further consolidation in this segment. The current valuations at 26x EV/EBTDA vs 24x in FY22 depicts the passing of the weak phase in the segment.

Diagnostics – Revenue growth (%) & EBITDA Margin (%)



Source: *TCHF Analysis, Capital IQ*

Diagnostics – EV/EBITDA



Source: *TCHF Analysis, Capital IQ*

6. Private capital valuations are higher across all segments except diagnostics

A comparison of transactions between listed and private companies are as per table below. We find that the listed segments of the sector such as healthcare delivery, CDMO and Pharma are at a discount to the private market valuations, but diagnostics is trading at significant premium compared to the private counterparts.

VALUATION COMPARISON	Median EV/EBITDA multiples (Unlisted entities)	Current EV/EBITDA multiples (Listed Entities)	Listed Valuation Discount/(Premium) to Unlisted entities (%)
Pharma – Domestic & Export	**~ 28x**	**18.4x**	50%
Diagnostics	**~ 13x**	**26.2x**	(110%)
CDMO/pharma services	**~ 14x**	**13.5x**	8%
Healthcare services	**~ 25x**	**21.2x**	20%

Source: *Capital IQ, Private Circle, Venture Intelligence database*

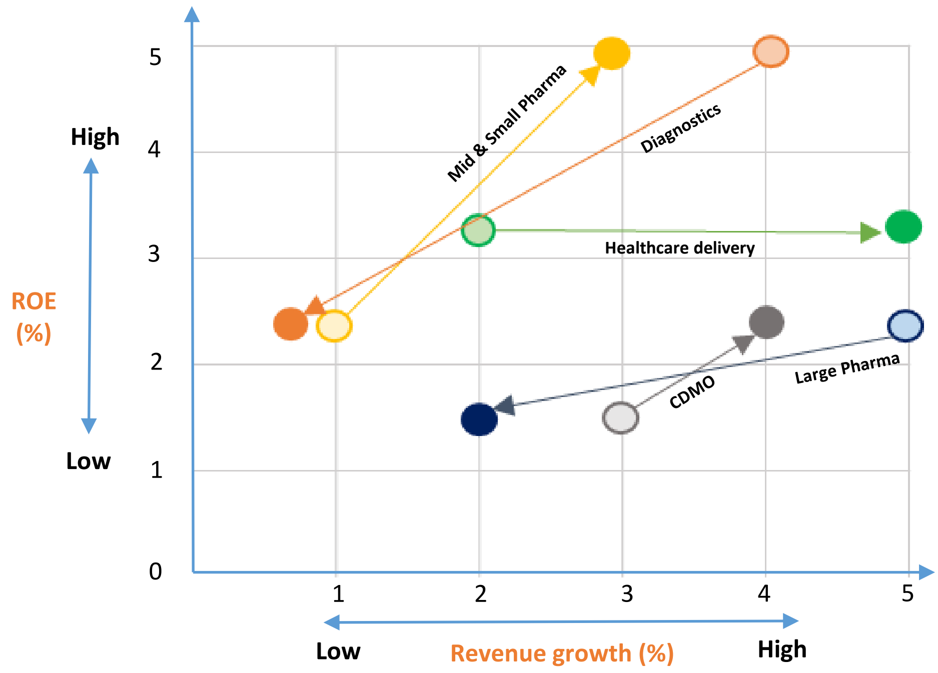
Key Conclusions

A deep-dive into the performance of the five sub-segments of the sector prior to COVID and currently in the listed universe has some interesting insights based on the graph depicted below:

(a) The healthcare delivery segment was underperforming prior to COVID, but has currently recorded the highest growth and margin expansion which we expect to continue well into FY24;
(b) The diagnostics segment has underperformed significantly from being the most promising space prior to COVID with high revenue growth and ROE's to the worst performing segment currently
(c) Within Pharmas, the 'Big Pharma' performance has lagged mid-cap pharma which has improved its ROE's and revenue growth
(d) Manufacturing plays in pharma continue to have strong fundamentals and positive tailwinds which are expected to continue attract investors

In conclusion, the public listed healthcare sector is beginning to show signs of recovery from historic valuation lows which highlights the strong fundamentals, resilience of the sector and investor interest in the sector.

Healthcare Sub-Segment – Ranking (LTM FY23 vs FY20)



Source: *TCHF analysis*

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.