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Investment

Why we focus on healthcare companies

Opportunities abound in healthcare due to the COVID-19 pandemic – now and into the future.

What do the stocks Cochlear, Fisher & Paykel Healthcare and Healius have in common? They're all part of the healthcare portfolio managed by Australian Ethical, one of the top-performing fund managers in the country.

The group's equities analyst Michael Murray explains why these shares made the grade and names the leading trends driving the growth of healthcare businesses.

Given the scale and pace that new technologies are reshaping the sector, Murray believes the need for better medical devices, including respiratory and ventilation products, will continue beyond the short-term demand arising from the pandemic.

Michelle Baltazar
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Director of Media & Publishing

All our investment decisions are guided by the Australian Ethical Charter, which is a list of 23 positive and negative principles that has been in place since our founding in 1986. As a result of the Charter, we tend to be overweight in several sectors we believe will have long-term benefits for society. Education, information technology and renewable energy are a few examples – but in this article I will look at the healthcare sector.

Healthcare has been a great sector to invest in over the past decade. Just looking at Australia, the S&P/ASX 300 Health Care Accumulation index has provided a compound return of around 20% over 10 years. Large companies like CSL stand out in the index, but there have been a range of stocks in the sector that have delivered outstanding returns for investors over the 10-year period.

There are several macroeconomic tailwinds that tend to drive above-GDP growth in healthcare spending. One that's familiar to most people is demographics, with the ageing population helping to steadily increase demand for healthcare services.

Another trend that is linked to ageing is the wealth effect, whereby people prioritise healthcare spending as they accumulate wealth – and that's something we see globally, not just in Australia.

Another interesting tailwind is the sheer pace of technological development in the healthcare sector. For example, there is a transformation underway in cancer care where immunotherapy drugs are generating improved outcomes for patients as well as creating new investment opportunities.

Plenty to choose from

Healthcare encompasses a broad spectrum of companies, setting it apart from more homogenous sectors like banking. We like to break healthcare down into three main areas: health services, medical device manufacturers and pharmaceuticals.

We have been able to find compelling investment ideas in a range of different areas and our process is relatively index unaware. That means we don't simply own the largest companies in the benchmark – instead, we focus on the most attractive opportunities. We also own lesser known companies in the small and micro-cap end of the market, which can create opportunities to capitalise on the experience we have built covering the sector in depth over a long time.

Some of the characteristics we look for are companies with durable intellectual property and a long runway of growth into global markets.

We also look for robust business models that we think will give companies a recurring revenue stream over time. We're also conscious of the role governments play in the healthcare sector for individual companies – for better or worse. A positive example is the federal government's decision to index diagnostic radiology services from 1 July 2020, which has helped some of the companies we are invested in.

Three companies we invest in

Cochlear is a good example of a medical device provider we have invested in over the long term. It's an Australian company that manufactures implants that simulate the workings of the inner ear. However, the implant is an elective procedure which means Cochlear's earnings fell during the initial COVID shutdown in March.

And the company was also hit with an unfavorable litigation outcome earlier this year, which meant it needed to come to the market to raise capital.

We were happy to participate, with Cochlear just one of a number of companies we helped recapitalise during the COVID period. Cochlear's share price has lagged some of its healthcare peers, yet we continue to see this as a very strong franchise that will be relatively unaffected by COVID over the long term.

Another one of our long-standing positions is Fisher & Paykel Healthcare, which specialises in humidification equipment used in patient ventilation. At the height of the global shutdown and stock market volatility earlier this year it was one of the few companies with an appreciating share price. We reduced some of our holdings in the stock at the time but we continue to maintain a position.

While there has been a spike in demand for its ventilation-related product, Fisher & Paykel Healthcare has developed a new respiratory product which has a much wider application throughout hospitals called 'nasal high flow'.

As COVID has progressed it has become more and more important for treating people who present with symptoms in hospitals. Overall, we think Fisher & Paykel Healthcare has longevity beyond the current pandemic with a high level of recurring revenue and ongoing growth from new products.

Finally, we also hold Healius, which was formerly known as Primary Health Care. It's a company that has underperformed over the long term and we have seen that as an opportunity to acquire the stock at attractive prices. Because Healius has a pathology business it has played a major role in the testing for COVID-19, which has helped it get through the pandemic relatively well.

Its balance sheet is also vastly improving as a result of the sale of its medical centre business. Assuming the company executes on its strategy, Healius should emerge from this pandemic as a pure play diagnostic and day hospital company trading at a healthy discount compared with its competitors. FS

The quote

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Watch the video on www.fsitv.com

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