



MINIRO

Area of interest

# Innovative Health



# The high-tech revolution

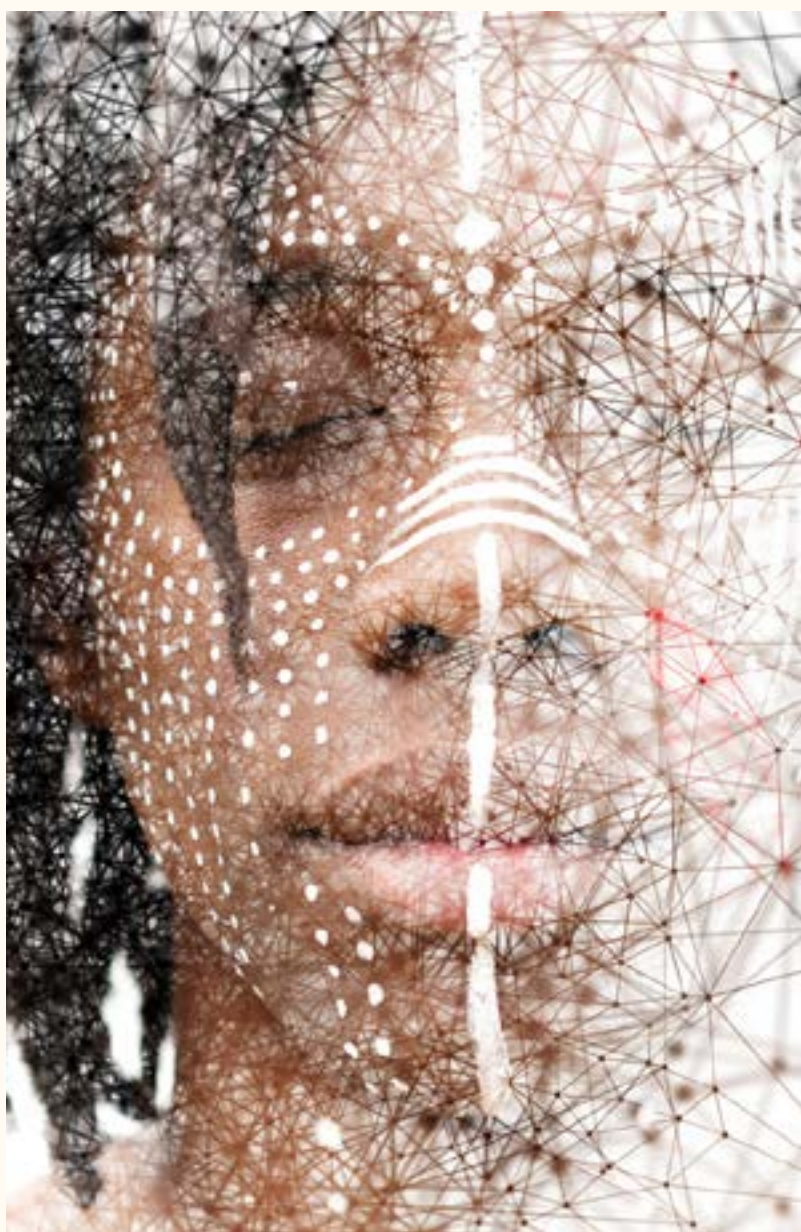
Prevention may be better than cure, but cure is more profitable.

Munro Partners has been investing in innovative health for over a decade, during which we've seen a global revolution in healthcare as exciting new technologies like machine learning, artificial intelligence (AI), virtual reality and genomics are transforming all areas of traditional healthcare, from diagnostics to disease prevention, drug treatments to aged care.

## KEY FACTS

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- Innovative Health is one of Munro's key Areas of Interest
- While the COVID pandemic brought specific investment opportunities, innovative health has been on a structural growth trend for over a decade
- Ageing populations, new technologies and rising costs are the key drivers of global health innovation.
- Biologic drugs are a significant growth area within healthcare and a key investment focus
- The future of innovative health will centre on the new science of genomics – but it's too early to yet identify potential long-term winners



Disparities in the availability and quality of healthcare around the globe are staggering, with over half the world's population still lacking access to the most essential health services.<sup>1</sup> In the developed world, demand for newer and more innovative medical products and services is higher than ever as life expectancies increase and the cost of providing health services continues to climb.

Life sciences academics, researchers, healthcare providers, drug manufacturers and those who invest in them therefore have the potential to literally save lives and improve the welfare of millions of people. At the same time, healthcare is one of the most profitable industries in our world today, with combined annual revenue across all sectors of global healthcare at around US\$1.66 trillion.<sup>2</sup>

Munro Partners has been investing in innovative health for over a decade, during which we've seen a global revolution in healthcare as exciting new technologies like machine learning, artificial intelligence (AI), virtual reality and genomics are transforming all areas of traditional healthcare, from diagnostics to disease prevention, drug treatments to aged care. Simply put, all the companies we invest in are using new technologies to provide better healthcare products.

## The drivers of healthcare innovation

Within the vast global healthcare landscape, structural change and innovation and the resulting investment opportunities are shaped by three key drivers:

### 1. Demographic change

Populations are ageing across the developed world. Life expectancy for a baby born in Australia in 2020 is 81.2 years for a boy and 85.3 years for a girl, whereas in 1990 the equivalent figures were 73.9 and 80.1 years respectively.<sup>3</sup> That huge demographic cohort, the Baby Boomers, are now between 58 and 76 years old.

Forty-six percent of Australians aged over 65 suffer from two or more chronic conditions compared with just 11% of those aged 15-44. Nearly half of all Australians aged over 75 have arthritis, and one in five has osteoporosis.<sup>4</sup> Disease prevention, treatment, and lifestyle management for the older members of society is a massive and growing subsector of the healthcare industry.

### 2. New technologies

Science, academia and healthcare companies ranging from start-up biotech pioneers to global pharmaceutical giants are inventing new products and processes to diagnose, treat or cure diseases or make healthcare provision more efficient. AI and the internet of things are making hospitals smarter while the use of predictive analytics can better manage patient volumes and staff-to-patient ratios. Micro robotics is used in surgical treatments previously considered dangerous and invasive. Innovations in genomics and gene therapy techniques may make possible a new era of personalised medicine instead of generic treatment plans for all patients with the same diagnosis. These and other innovations offer a fascinating range of potential opportunities for long-term growth investors.

### 3. The rising cost of healthcare

Global spending on health reached a staggering 9.8% of global GDP, according to the World Health Organisation.<sup>5</sup> However, health spending per capita in high income countries was more than four times higher than in low income countries, with the US healthcare system alone accounting for 42% of total global health spending. Products, processes and technological systems that reduce the cost of healthcare provision are therefore fertile areas to invest in. For example, United Healthcare Group is a global healthcare service provider leading a shift in focus from the quantity of services delivered to a more efficient 'value-based' care approach.



## The Munro approach to innovative health

Given the breadth and diversity of the global healthcare industry, we have identified several sub-categories within our overarching Innovative Health Area of Interest (Aoi), including:

- Life sciences and particularly areas like biologics and bio-processing, where companies such as Danaher (see below) and ThermoFisher are dominant.
- Healthcare services, in which global provider United Healthcare Group is a prime example.
- Medical technology – for example in diabetes management where companies such as Abbott Laboratories and Dexcom have developed continuous glucose monitors to track blood sugar levels to replace the previous pin-prick test.
- Diagnostics, in which Abbott Labs, Danaher and ThermoFisher are also active.
- Genomics, cell and gene therapies. These are the new frontiers of medical science and still in their early years from the investment viewpoint. Companies active in this area are highly innovative and spending heavily in research and development, but generally aren't profitable today.

Across these subcategories and despite the scale and complexity of the global healthcare industry our underlying investment thesis for innovative health is simple and consistent: to focus on companies that create and make the new products and processes that enable better, faster and more reliable health outcomes.

When considering global healthcare it's impossible to ignore the pervasive dominance of Big Pharma. Yet for Munro Partners, as long-term growth investors, the big brand pharmaceutical giants haven't been a key focus because they tend to have massive existing drug manufacturing programs, some of which have patent expiries in the not too distant future. The new drugs and medical innovations the Big Pharma companies introduce, however successful, tend to have a disproportionately small impact on business growth.

That said, we've recently been looking at two pharmaceutical multinationals that are developing drugs combating the burgeoning global problem of chronic obesity. American company Eli Lilly and Danish pharmaceutical giant Novo Nordisk have shown that their glucagon like peptide drugs (traditionally prescribed for diabetes), have the effect of reducing weight loss in the range of 15-20%. These drugs have the ability of not only improving the outcome for the patient by enabling them to avoid bariatric surgery, but also reducing cost in global healthcare systems by treating obesity before other conditions develop such as heart or kidney disease. We believe the global obesity market opportunity could be in excess of USD\$50bn in years to come and is very under-penetrated today, creating a long runway for earnings growth.

## Healthcare in the global spotlight

Healthcare cost and sustainability was already one of the biggest challenges faced by governments worldwide long before the COVID pandemic began to dominate the news in early 2020. Indeed, in some ways the pandemic has distracted from the wider healthcare technology revolution that was already well underway and will continue to accelerate in the years ahead.

As the many elements of the COVID pandemic played out, Munro Partners decided to concentrate on the vaccine supply chain, which seemed a fairly obvious place to invest. The more we researched the opportunities in this area the more we focused on biologic drugs, which were critical in the development of the next generation mRNA (messenger ribonucleic acid) vaccines that were the principal weapon available to governments in bringing the pandemic to an end.



## The shovels in the COVID vaccine gold rush

Biologic drugs are developed from cell culture media or living organisms that are then purified and processed, as opposed to traditional compound drugs such as Panadol that are made via a chemical synthesising process. Biologic drugs specifically target the disease they're designed to attack, resulting in much higher efficacy and fewer side effects.

### Biological drugs – what is it and how are they made? MUNRO

#### BIOLOGICS V TRADITIONAL DRUGS (SMALL-MOLECULES) - DIFFERENCES

Characteristics	Biologics	Traditional (Small-molecules)
STRUCTURE	More complex structures extracted from <b>living organisms</b>	Relatively simple <b>chemical compounds</b>
MECHANISM	Delivery method not as simple (injection, other means) – <b>targets specific parts of the body.</b>	Easily delivered to patients via capsules – goes to all parts of the body. Has <b>higher risk of unwanted side effects.</b>

More single use  
=  
more consumables  
=  
higher recurring revenue

#### BIOLOGICS – MANUFACTURING PROCESS



Source: Danaher JPM Healthcare Conference, 15 Jan 2022

Munro Partners was already invested in this area well before COVID via companies like Danaher and ThermoFisher, since they were already benefiting from the structural growth of biologics as these new drugs began to take market share from traditional compound medications.

When the pandemic hit, investment opportunities quickly emerged among the biologics companies racing to develop COVID vaccines. However, we decided to focus instead on the companies supplying the consumable equipment needed by the vaccine producers, a strategy we see as akin to investing in the picks and shovels that enabled the gold rush. For example, Danaher’s customers already included Moderna and Pfizer, two of the eventual big winners in the COVID vaccine race. But Danaher was also a supplier to several other ultimately unsuccessful vaccine developers. We always regarded Danaher as a potential winner so increased our investment, rather than trying to predict which of the vaccine makers would win out. On top of that, Danaher was also quick to develop COVID tests.

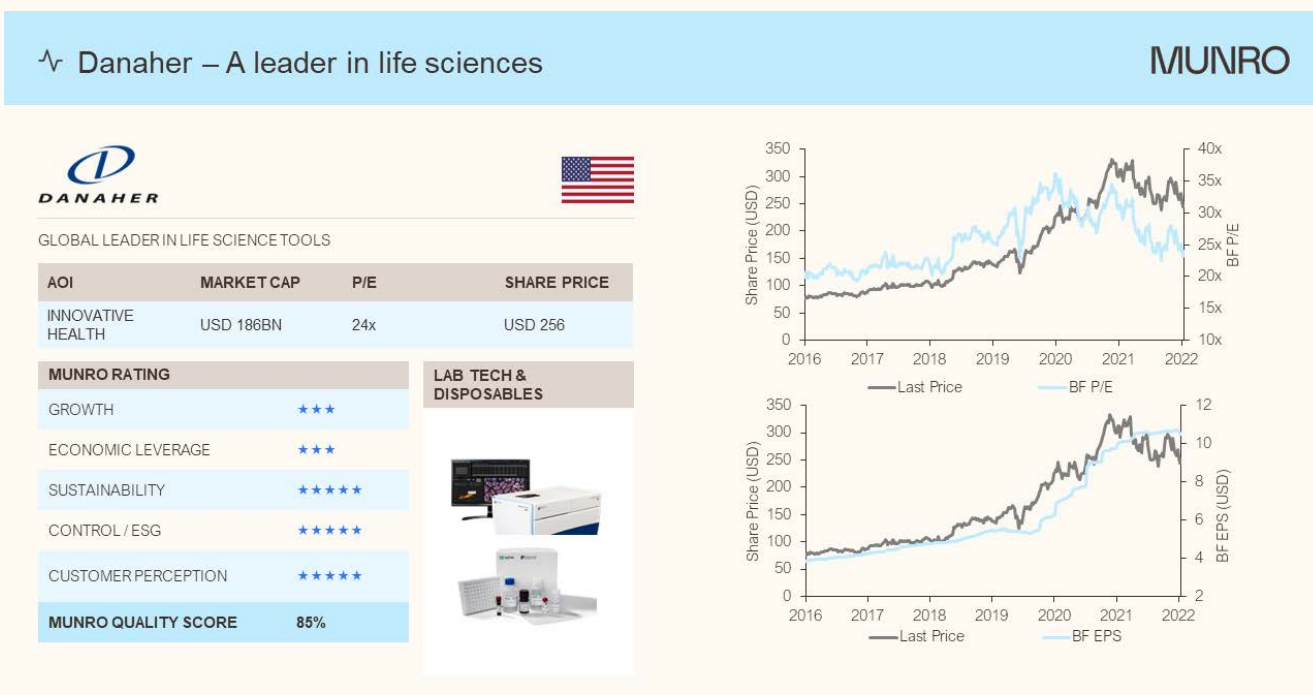
So, while Danaher and other companies in the biologics sector benefited hugely from the pandemic it’s important to note that they were already ascending well before COVID, and there only been a modest post-COVID lag in orders, the underlying growth of these companies is faster now that in was pre-pandemic.



## Stock story: Danaher Corporation

Danaher is a US listed company and is Munro Partners' biggest position in innovative health at the time of writing. Danaher is a specialist in life science products, which make up over 50 percent of group profits. Production of biologic drugs is highly complex and needs a lot of specialist equipment, much of which can only be used once. Danaher is a major provider of the consumable products on which the biologic drug developers rely, such as the filtration equipment and cell culture products – which provide a very high recurring revenue stream for the company.

Clearly, Danaher's revenues will continue to benefit as biologics take further market share from regular drugs, and as vaccine development becomes more complicated – for example with the mRNA vaccines (as distinct from regular protein vaccines) which emerged through the COVID pandemic.



Source: Bloomberg Finance L.P 02 November 2022

### ONE NAME, MANY COMPANIES

Danaher's organizational philosophy is different from most because it has a decentralised structure with over 20 different operating companies.<sup>7</sup> So as well as the life sciences division it has a diagnostics business which also benefited through COVID, while also producing non-COVID tests, an area which is growing strongly.

The organisation has an operating ethos it calls the Danaher Business System (DBS) that drives culture, performance and success – or as Danaher puts it, “DBS is who we are and how we do what we do”. Danaher is adept at acquiring existing businesses or technologies, adding value and then either spinning them off or investing heavily in the newly acquired technology and adding that new business to its distribution network.

Danaher rose to greater prominence in 2020 when it acquired GE's bio-pharma business, GE Healthcare Life Sciences, for US\$21.4bn.<sup>8</sup> GE was in financial trouble and in a sense was having to 'sell their crown jewels' – so this was a great deal for Danaher. Renamed Cytiva, the acquired business is now a standalone operating company within Danaher's life sciences division.



## SUSTAINABILITY BY INNOVATION

Cytiva is but one example of the many excellent businesses Danaher has acquired and grown over the last couple of decades. Rather than big mergers or takeovers, these bolt-on acquisitions have tended to be smaller deals that Danaher can buy with their free cash flow. It has done this many times now, particularly with vaccine technologies or other pieces of the biologics puzzle it has wanted to move into – and we expect it to keep doing this for a very long time to come.

We see Danaher's investment philosophy as highly sustainable, where instead of focusing on taking costs out and growing margins and profits that way, when it buys a business or seeks to grow one of its existing businesses it increases research and development spend and grows gross margins by charging higher prices for its more innovative products. On top of that, in the more macro sense they're exposed to a good combination of structural growth and resilience in an economic downturn.

## A CLEAR INVESTMENT HORIZON

Danaher is now an established leader in the life sciences field and has been enjoying high single digit organic revenue growth. If it holds its mid 20s earnings multiple, then its share price will continue to follow its earnings – which is what Munro looks for in all the companies in our portfolios. And with Danaher, we don't see much on the horizon to halt its long-term growth given the potential of biologic drugs to transform global health outcomes.

Capital allocation champion with cash to deploy **MUNRO**

POSITIVE EVOLUTION OF DANAHER PORTFOLIO



SUCCESSFUL M&A TRACK RECORD – CEPHIED CASE STUDY



Source: Danaher JPM Healthcare Conference, 15 Jan 2022



## Where to next for innovative health?

We see the long-term outlook in health innovation as becoming increasingly about cell and gene therapies and genomics. This is where modern medicine is trending towards. Danaher and its life sciences tools peers have been positioning to again be “picks-and-shovels” winners as they provide instruments and consumables to address the production of such solutions. Munro Partners will be keeping a keen eye on how this exciting new field of medical science unfolds and be ready as always to take early advantage of emerging investment opportunities.

### DISCLAIMER

Munro Partners investment process aims to identify long-term structural growth trends or “Areas of Interest” (AoI); the associated sub trends and ultimately the companies most likely to benefit from these trends, through a disciplined qualitative and quantitative research process.

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### Sources

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