Industry Top Trends 2021

Health Care

Resilient Industry, But Negative Outlook Persists

What’s changed?

Recovery from the COVID-19 pandemic ongoing. The health care industry has held up relatively well through the pandemic, though the impact was uneven across the subsectors, highlighting the more discretionary parts of the industry.

Accelerated pace of disruption. The pandemic accelerated already ongoing disruption, such as increasing use of telemedicine.

Increasingly negative outlook portends future downgrades. COVID-19 aside, the continued pressures on pricing, calls for greater transparency, and mergers and acquisitions (M&A) continue to exert downward pressure on the ratings.

What are the key assumptions for 2021?

Industry to largely recover. The pandemic’s impact was uneven, with pharmaceutical makers largely insulated while hospitals and health care service providers hit hard. Most subsectors’ revenues will largely recover.

M&A activity to continue/resume. M&A was largely put on hold in the first half of 2021. As the economy recovers, health care companies will resume significant M&A, as the pharmaceutical industry already has in the second half of 2020.

Health care reform in U.S. to continue to be gradual. The complexity of the issues and partisanship in Washington make U.S. health care reform a slow process.

What are the key risks around the baseline?

Third wave of pandemic. The pandemic led to a large drop in patient and procedure volume. A resurgence in COVID-19 cases could again lead to a rapid decline.

Margin pressures. Increased pricing pressure as well as potential adverse payor mix shift due to rising uninsured in U.S. could lead to deteriorating credit metrics.

Accelerated pace of legislative change. The rising number of uninsured and strains on state budgets could quicken the pace of health care reform in the U.S.
Ratings trends and outlook

Global Health Care

Chart 1
Ratings distribution by region

Chart 2
Ratings distribution by subsector

Chart 3
Ratings outlooks

Chart 4
Ratings outlooks by subsector

Chart 5
Ratings outlook net bias

Chart 6
Ratings net outlook bias by subsector

Shape of recovery

Table 1

<table>
<thead>
<tr>
<th>Sensitivities and Structural Factors</th>
<th>Shape Of Recovery</th>
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<tr>
<td>Health Care</td>
<td>Moderate</td>
</tr>
<tr>
<td>Europe</td>
<td>Moderate</td>
</tr>
<tr>
<td>Latin America</td>
<td>Low</td>
</tr>
<tr>
<td>North America</td>
<td>Moderate</td>
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Source: S&P Global Ratings.

S&P Global Ratings believes there remains a high degree of uncertainty about the evolution of the coronavirus pandemic. Reports that at least one experimental vaccine is highly effective and might gain initial approval by the end of the year are promising, but this is merely the first step toward a return to social and economic normality; equally critical is the widespread availability of effective immunization, which could come by the middle of next year. We use this assumption in assessing the economic and credit implications associated with the pandemic (see our research here: [www.spglobal.com/ratings](http://www.spglobal.com/ratings)). As the situation evolves, we will update our assumptions and estimates accordingly.

This report does not constitute a ratings action.
Health Care

Ratings trends and outlook

Our ratings outlook for the health care industry remains negative, especially in the hospital and health care services sector, which had been harder hit due to the pandemic, and saw a steep drop in medical procedure and patient volumes putting a strain on financials. In contrast, the outlook for the medical device and products and life science subsectors remained steadfastly stable.

Our outlook on the health care sector had already been trending negative because of ongoing (and, under the pandemic, accelerating) disruption in the industry, such as payor pressure on pricing and technology (e.g., big data, telemedicine) and the increasing industry M&A in response to that disruption.

While we have seen a faster-than-expected recovery in health care activity from the early chaotic months of the pandemic, and a reversal of a number of pandemic-derived negative outlooks, the sustainability of the recovery and the potential of another drop in procedure volume as we enter the colder months remain in focus. We believe 2021 will be quite similar to 2020 for at least the first half of next year, assuming the COVID-19 vaccine comes to market. The promising news of several COVID-19 vaccines is encouraging, but even assuming successful approval, manufacturing and distribution complexities will limit the upside until sometime mid-2021.

Hospitals and health care service providers remain vulnerable.

For hospitals and health care service providers, the key question is whether the resurgence of COVID-19 cases leads again to as severe a drop in medical procedures and patient volumes as in the first half of 2020, putting pressure on their financial metrics. Also vulnerable, to a lesser extent, are medical device and product manufacturers supplying devices, diagnostics, and products for the procedures. Our current view is that a third pandemic wave will not trigger the same level of restrictive lockdowns as the first wave. Hospitals and service providers will be more flexible in scheduling procedures and previous medical device and supply shortages will be less severe given recent stockpiling.

Hospitals have been able to cut costs to counter the drop in elective procedures and government aid monies, such as the CARES (Coronavirus Aid, Relief, and Economic Security) Act in the U.S., provided relief and a cushion against uncertainty. However, hospitals in harder hit areas were overwhelmed by COVID-19 cases and incurred significantly elevated costs, such as labor (outsourced nursing and doctors), and saw negative margins even with the government aid. We are uncertain whether there will be additional aid and how long-lasting cost saving measures are, and we view pharma, medical devices, hospitals, and health care service providers remain some of the more vulnerable subsectors to a COVID-19 resurgence.

Outlook on European pharma is more stable.

While new prescription volumes in certain therapeutic categories dropped and clinical trial recruitment was disrupted, the pharmaceutical industry was not affected by the pandemic to the same extent as the hospitals and health care service sectors. Increased use of telemedicine and prescription mail order helped keep prescription volumes high.

However, the pharmaceutical industry’s rating quality deteriorated further in 2020 than in 2019, and the negative outlook bias for the sector also increased, leading to the potential for more downgrades in 2021. The main reason for the deterioration was M&A, as industry players increased their efforts to diversify their portfolios and better stock their pipelines in anticipation of growing pressure from powerful payors and increased legislation on pricing in the U.S.
Europe-based pharma layers have been more moderate on the acquisition front than their North American counterparts, and that is reflected in a more stable outlook for European pharma as a group.

**Main assumptions about 2021 and beyond**

1. **Health care spending growth to remain modestly above GDP growth.**

   Given the largely nondiscretionary nature of health care products and services, we believe health care spending will grow, especially versus the depressed spending levels seen in 2020.

2. **M&A activity resumes at a high level, pressuring credit metrics.**

   M&A activity dropped significantly in the 2020, due mainly to management focusing on the pandemic’s impact to operations. As the industry recovery continues, we expect M&A activity to return to the previous high levels, again pressuring credit metrics.

3. **Health care reform in the U.S. will continue at gradual pace.**

   We do expect any major health care reform legislation in the U.S. in 2021 and likely into 2022 given the complexity of many proposals as well as continued partisanship in Washington.

**Health care spending growth to remain modestly above GDP growth.**

The health care industry has been largely resilient through the pandemic, mainly due to the largely nondiscretionary nature of health care, but also through increasing use of technology, such as telemedicine. However, we do believe health care spending growth will be more moderate in 2021 than in pre-pandemic years, as we do expect some negative impact to demand given the elevated unemployment in the U.S. and related loss of health care coverage. Also, even if demand rebounds, we have concerns on the potential of an adverse payor mix (e.g., shift to lower-paying Medicaid) shrinking margins.

**M&A activity resumes at a high level, pressuring credit metrics.**

Many health care service companies resorted to M&A in order to increase their size and scale as well as diversify their service offerings. Pharmaceutical companies turned to acquisitions to broaden their drug portfolios and pipelines. Meanwhile, medical device and life science companies continued their consolidation as they sought to expand their offerings to customers. The high level of M&A led to a deterioration of credit metrics and has been the leading reason for the ratings deterioration in health care over the past several years.

With the pandemic, M&A activity dropped significantly. As the industry continues to recover, we expect M&A to steadily return, as it already has in the pharmaceutical industry (e.g., Gilead’s $21 billion acquisition of Immunomedics Inc. and Bristol-Myers’ $13.1 billion acquisition of MyoKardia). Thus, credit metrics will likely deteriorate, along with credit ratings.
Healthcare reform in U.S. to remain at a snail's pace.

We believe that while health care reform will continue in the U.S., the largest health care market, it will continue to be slow, and we do not expect major legislation to be passed in the near term for three main reasons:

– Complexity of the major proposals and continued partisanship in Washington.
– Main priorities of the new Biden administration will be the pandemic and the economy.
– President-elect Biden has more of a moderate stance on health care reform than some other Democrats.

The president-elect could have a split U.S. Congress: two U.S. Senate runoff elections are scheduled in January, the Republicans currently hold a 50-48 Senate majority, and the Democrats maintain control of the House. Given that, we expect the high degree of partisanship among lawmakers to persist, and believe getting far-reaching health care reform policies through Congress will be time consuming and compromised. The Biden administration will also likely prioritize handling the pandemic and the weakened U.S. economy for most of 2021.

Still, we believe the health care industry remains legislatively exposed, given bipartisan consensus on issues such as transparency from the hospitals and service providers and pricing limits for the pharmaceutical industry. Thus, while the likelihood of something being passed and implemented in the near term to remain low, the potential impact of legislation will increase under the new administration.

Credit metrics and financial policy

Consistent with our negative outlook on the industry, we continue to expect a deterioration in credit metrics, due mainly to continued pricing pressure from payors (with the potential for legislative price controls longer term), increasing M&A activity in the normally very financially conservative pharmaceutical sector, and the resumption of M&A activity in the health care services space as they aggressively seek to increase scale and diversify service offerings. Private equity, which is traditionally highly aggressive from a financial policy front, continues to favor the health care sector as a focus of investment.

The pandemic has also left a negative impact on the industry’s credit metrics, especially for the health care services sector. We do not see a full recovery of revenues for many of the service subsectors until the second half of 2021, and are still uncertain on EBITDA margins.
## Key risks or opportunities around the baseline

### 1. Resurgence in COVID-19 cases could delay recovery past 2021.

The ability of hospitals and health care service providers to resume scheduled surgeries and medical procedures is critical. Elective procedures were delayed or canceled and patient volumes declined significantly in the depths of the first wave, creating financial strain for hospitals and service providers. The rapid influx of COVID-19 patients in certain geographies also overwhelmed local health care providers. We have seen a strong rebound in procedure and patient volumes, especially as certain procedures can only be delayed so long. The coming months should bring clarity regarding the capacity of health care services to clear the backlog of delayed treatments in 2020 through to 2021. It is nevertheless unclear whether the activity lost in 2020 could be recovered fully next year. Even in case of high demand, capacity could be a bottleneck. In the meantime, we are concerned with the resurgence in COVID-19 cases and what it means for procedure volumes.

### 2. Margin pressures will likely persist.

Pressure on margins will remain into 2021 due to social distancing measures, at least until a vaccine is available to medical staff and high-risk patient groups. Also, we expect a risk of inflation on salaries amid shortage of qualified staff. Owing to the high contamination risk and the work overload, appetite for working in clinics and/or nursing homes has markedly decreased. Hiring will be more difficult than in the past and therefore more costly.

### 3. Future government support adequacy.

A curtailment of government support to certain health care subsectors, especially should the pandemic extend deep into 2021, would lead to financial difficulties for many companies. Governments could decide to cease providing promised assistance to support the delivery of services and to cope with higher costs, which would pressure margins. Whereas we note continuous and tangible support from the French and German governments, we see less evidence of such help from other countries like Spain.

### 4. COVID-19 vaccine, treatments, and increased diagnostics demand.

While the pandemic was a headwind for the health care industry, the pandemic also increased the demand for potential COVID-19 vaccines and treatments, diagnostic tests, and medical equipment and supplies. The demand has turned into a net tailwind for some players and that should persist into 2021. Several pharmaceutical companies have promising vaccine candidates in late-stage development, including Pfizer, AstraZeneca, and Moderna, that can result in tens of billions of dollars of sales. Several drugs are also being looked at as potential treatments, such as Regeneron’s REGN-COV2. The development of effective and safe vaccines and treatments is also an opportunity for the pharmaceutical industry to enhance its long-beleaguered public image, especially if the vaccines and treatments are low to no margin. This may soften the governments’ and the public’s effort to curtail drug pricing. Life science companies have also seen a net tailwind. Despite the decline in medical procedures resulting in less demand for pre-procedure diagnostic tests, this has been more than offset by increased demand for COVID-19 tests and for products used in the research and production of vaccines.
Related Research

– Credit FAQ: Medical Devices and Life Sciences: Improving Vitals, Ratings Remain in Guarded Condition, Sept. 10, 2020
– What Does Pharma’s Quest For COVID-19 Vaccine Mean For Its Credit Quality and ESG Profile?, July 8, 2020
– A Bumpy Recovery is Ahead for Hospitals And Other Health Providers as Non-Emergent Procedures Restart, May 26, 2020
– COVID-19: The Road Ahead is Bumpy as the European Health Care Sector Recovers, May 19, 2020
Industry forecasts

Global Health Care

Chart 7
Revenue growth (local currency)

Chart 8
EBITDA margin (adjusted)

Chart 9
Debt / EBITDA (median, adjusted)

Chart 10
FFO / Debt (median, adjusted)

Source: S&P Global Ratings. Revenue growth shows local currency growth weighted by prior-year common-currency revenue-share. All other figures are converted into U.S. Dollars using historic exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO—Funds from operations.
Cash, debt, and returns

Global Health Care

Chart 11
Cash flow and primary uses
- Capex
- Dividends
- Net Acquisitions
- Share Buybacks

Chart 12
Return on capital employed
- Global Healthcare - Cash & Equivalents/Total Assets (%)

Chart 13
Fixed versus variable rate exposure
- Variable Rate Debt (% of Identifiable Total)
- Fixed Rate Debt (% of Identifiable Total)

Chart 14
Long term debt term structure
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- LT Debt Due 2 Yr
- LT Debt Due 3 Yr
- LT Debt Due 4 Yr
- LT Debt Due 5 Yr
- LT Debt Due 5+ Yr
- Val. Due In 1 Yr [RHS]

Chart 15
Cash and equivalents / Total assets
- Global Healthcare - Cash & Equivalents/Total Assets (%)

Chart 16
Total debt / Total assets
- Global Healthcare - Total Debt / Total Assets (%)

Source: S&P Global Market Intelligence, S&P Global Ratings calculations. Most recent (2020) figures are using last twelve months (LTM) data.