

## Rosefinch Research | 2024 Series # 9

### Biopharmaceutical – Inelastic Demand and Export Opportunities



Under the influence of multiple factors, the Beauty Care Index in 2023 rallied over 30%, and medical services and medical devices also had significant adjustments. In the process of bubble deflation, it's worth tracking which directions still have significant upside room, which fields are quietly warming up, and which innovations deserve attention. The following is an analysis at Rosefinch research team's 2023 annual strategy meeting in December.

#### 1. Beauty Care

We started paying attention to innovation in the field of recombinant collagen two years ago, when many people questioned whether "recombinant collagen" was just intellectual tax and why there were no precedents abroad. But now recombinant collagen has become a hot track in the market, and is one of the fastest growing categories during 11/11 for skincare products. Risheng Group, the parent company of Shiseido, invested in Chinese manufacturers, and L'Oreal also invested in this field through strategic cooperation, adding recombinant collagen raw materials to flagship brands such as Paris L'Oreal, thus largely validating China's leading position in independent technology in the field of recombinant collagen internationally.

At that time, some also questioned why we needed to attach importance to technology. Our understanding is that first of all, legal and regulatory requirements for efficacy cosmetics have become higher, and consumers are more rational and willing to purchase truly effective products and technologies. Enterprises have also increased independent research and development investment and promote the brand story of science and technology aesthetics. So attaching importance to research and development has actually

become a trend of this industry chain. Medical beauty products have even higher technical barriers, requiring analysis of clinical efficacy, allergic rates, and safety.

The current upbeat situation largely validates our forward-looking judgment. Looking ahead, in the sub-tracks of recombinant collagen, raw materials have great exploration space. In addition to the currently dominant types I and III collagen mainly functioned in repair and anti-aging, other functions remain to be developed. Moreover, type XVII collagen can be developed for anti-loss functions. On the market side, with more skincare brands focusing on it, there is still great room for growth, and domestic brand products are also at the forefront internationally. In addition, with the approval of new indications and better products, the potential of recombinant collagen in the medical beauty field has just begun to be unleashed.

In our research, we are committed to improving professionalism: medical beauty involves technical means to become beautiful through solutions, involving synthetic biology techniques, as well as innovative drug development, with certain knowledge barriers. At the same time, close research is also needed on the upstream and downstream industrial chains, from universities, research institutes to terminal institution distributors, doctors, and consumers. Integrating the accumulated experience of our bioscience group, we also have certain advantages in clinical data research and understanding of policies and regulations, such as regulating hyaluronic acid according to medical device standards and botulinum toxin according to toxalbumin drug standards. In the past two years, with the gradual improvement and standardization of medical beauty product approval conditions, the entry threshold for the medical beauty industry has further increased.

Beauty care is a long slope with heavy snow cover, and its PE ratio estimate at the end of 2023 has reached 20-30 times, or even 10-15 times, which is historically low. Based on our solid previous research accumulation and ecological construction, we are confident to seize future opportunities.

## 2. Medical Care

At the beginning of 2023, the post-epidemic recovery of medical services was obvious, but from the second quarter, differentiation began to appear among different sectors. Excluding medical aesthetics, ophthalmology and dentistry, consumer-oriented medical service enterprises were generally affected by macroeconomics and consumption downgrading, while demand for essential diagnosis and treatment is more likely to recover in a more stable manner.

Looking ahead, demand is still very certain from two aspects. On one hand, it comes from the acceleration of population aging: The baby boomers born in 1962 began entering their 60s last year, and according to public data, in the next decade, about 20 million people will enter their 60s annually. The incidence rates of chronic diseases such as cardiovascular, cerebrovascular diseases, malignant tumors and diabetes will increase significantly with age, and outpatient and hospital medical expenses for the elderly are far higher than for young people. On the other hand, the new generation entering old age, whether payment ability,

medical insurance, and awareness, have requirements for higher quality of life, so the demand for medical services is more likely to further expand and grow.

Public data show that the benchmark equities in the medical services sector generally fell by more than 30% in 2023. In 2024, we will focus on "essential recovery" in these areas that may be less affected by the macro economy. We conduct in-depth investigation and comprehensive judgment from the perspective of integrating "three medicals" - medical, pharmaceutical, and medical insurance. The future direction may likely be increasing charging for technical services by squeezing out inventory from drugs and consumables, especially in areas with higher technical content.

Qualified medical resources have always been scarce on the supply side. Private hospitals are more likely to remain as effective supplements to public hospitals, and will also face elimination of the uncompetitive under medical insurance payment reform. For listed medical service groups, targets in the primary market are relatively cheaper, and M&A expansion costs are also lower than in previous years. Each grasps industry development opportunities with its own strengths.

We are committed to finding high-quality private medical service groups, mainly assessing enterprise competitiveness from two dimensions: First, companies have solid medical technology quality, including the proportion of difficult surgeries, academic research capabilities, independent pricing capabilities, and proportion of self-paid projects. Second, comprehensive consideration of management efficiency, refined operations and financial balance. In terms of value assessment, we refine financial models and find trackable key variables through valuation models to make a more accurate judgment on changes in fundamentals.

### 3. Medical Equipment

First, the growth potential for the medical device sector is relatively large. The penetration rate of domestic interventional cardiology and neurosurgery, the inventory of equipment such as magnetic resonance imaging, are still relatively lower compared with abroad. Secondly, technological updates bring new demands, including landing applications of artificial intelligence, using medical imaging AI-assisted diagnosis as an example. During the epidemic period, fully automatic CT was introduced without the need for doctors to operate to complete imaging examinations, further avoiding infection. China's medical industry innovation is changing day by day, and the engineer dividend in the medical field will be further reflected in the future.

The medical device index has fallen by 40% since June 2021, during which it was affected by lockdowns, centralized procurement, and anti-corruption. We believe that medical product research should still focus on the products themselves, because the payment end policies encourage innovation. Therefore, we established a research philosophy with product competitiveness at the core early on, looking for areas with large import substitution space in the domestic market, and companies with export capabilities.

How will we finally determine investment? The focus is to evaluate different companies' products from the doctor's perspective. Through in-depth interviews and research with frontline doctors, we better understand parameters such as usability, quality and risk of products, so as to better predict which products are "true innovation" in advance.

We focus on two types of companies: one type is companies with large callbacks affected by negative industry impacts; the other type is companies in new technology and new fields. Downside risks are limited, and upside has elasticity, so these types of targets are most likely what we focus on.

Finding high-growth industries may not be difficult, but the challenge is how to make left-side judgments and deployments when facing risks. We will continue to adopt the product value judgment methodology to excavate targets that truly have core competitiveness, such as chemical luminescence, medical imaging, electrophysiology, endoscopy, and other fields.

**We hope that by sharing Rosefinch's views, we add value to your day.**

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