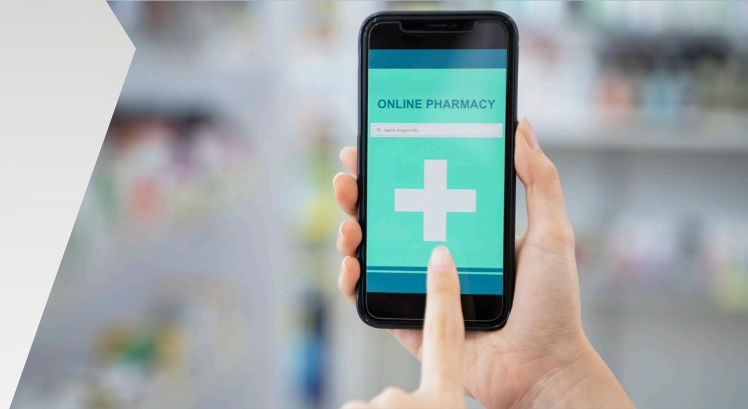




China: Digitalisation hastens the healthtech boom



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Changing demographics, rising affluence, lifestyle diseases and growing health consciousness are expected to fuel China's healthcare sector's growth. A shortage of medical professionals and high costs, however, are key challenges. Fortunately, the ongoing digitalisation is helping to alleviate some pressure, and this is resulting in many exciting investment opportunities.

China's healthcare expenditure is expected to almost triple from RMB 6.5 trillion in 2019 to RMB 17.6 trillion by 2030¹, precipitating tandem growth in many other sub sectors such as drug sales, medical device sales, distributors etc. The landscape has also been evolving over the past decade with concurrent advances in technology. In fact, online healthcare expenditure has increased 2.5x since 2015.

China's healthtech boom came only in the last 2 years following the implementation of a comprehensive framework to regulate online healthcare in 2018. The new regulations allowed 1) hospitals to use online platforms to collaborate amongst themselves 2) offline hospitals to provide

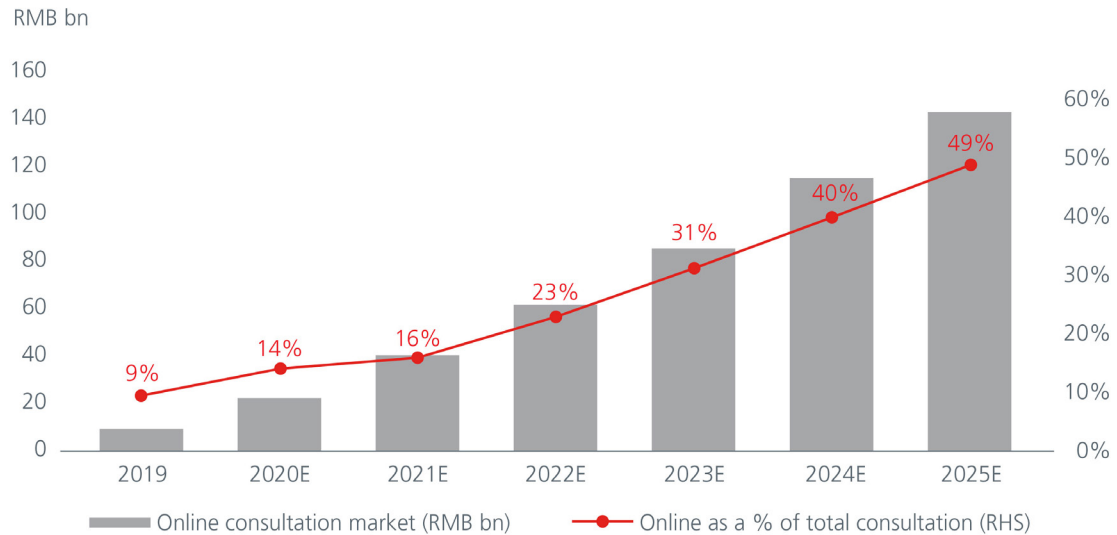
online solutions, and 3) companies to set up an "internet hospital" if it works with an offline hospital. Internet hospitals can efficiently tap on services of doctors and nurses from various hospitals.

Meanwhile COVID-19 has further accelerated the digitalisation of the healthcare sector with many turning to telehealth for medical consultations. Given that almost 986 million people in China accessed the internet via a mobile device in 2020², facilitated by the world's fastest 5G technology, connecting to online medical services is a non-issue. Two areas that we believe are poised to benefit greatly from telemedicine's rise are online drug sales and artificial intelligence (AI) for medical diagnosis. See Fig 1.

A PROMISING FUTURE FOR ONLINE DRUG SALES

Online drug sales have not taken off in China for a few reasons. The traditional mindset of Chinese patients is one. Many believe that public hospitals have the best quality doctors and best available medicines, and hence avoided buying drugs online.

Fig 1: Online consultation market is expanding

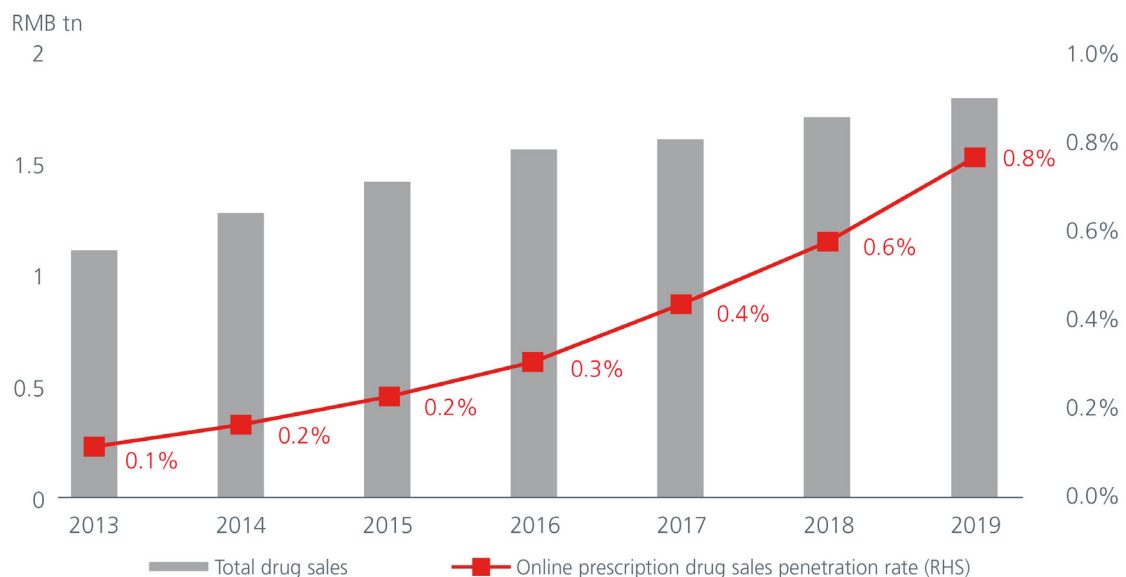


Source: Frost & Sullivan, Goldman Sachs Global Investment Research, Jan 2021.

As a result, 70% of drug sales take place in public hospitals across China and the remaining market share is taken up pharmacies; online drug sales constitute less than 1% of the RMB 1.8 trillion market. See Fig 2.

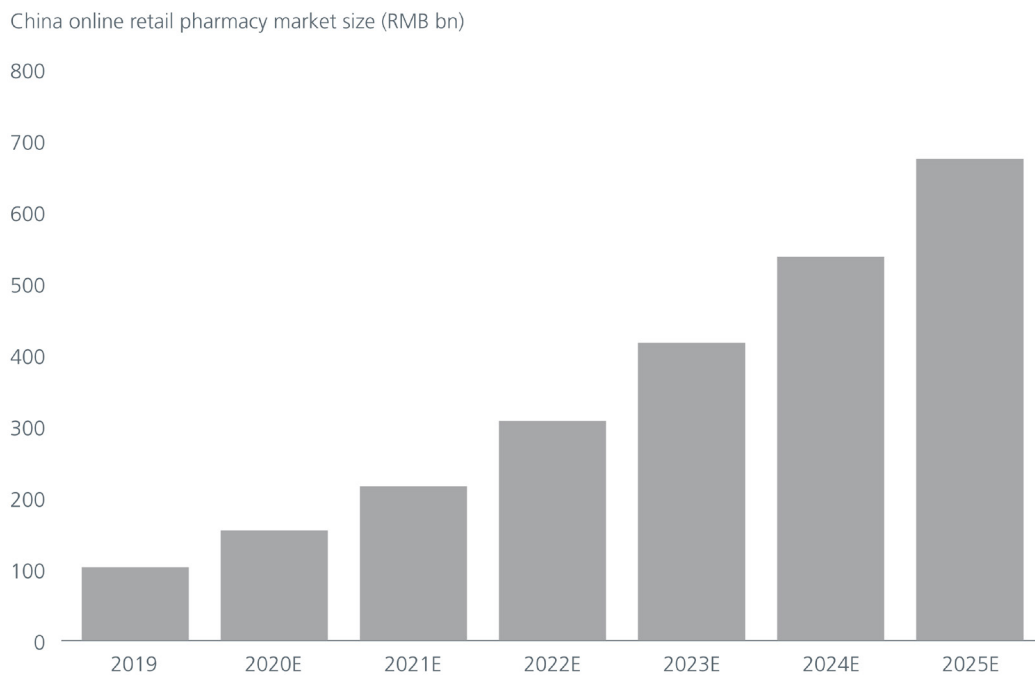
But we believe the current model is changing and that online drug sales will see strong structural growth, backed by favourable regulations. In November 2000, the regulator issued draft regulations detailing the legal framework for online

Fig 2: Online drug sales is a mere fraction of the total drug sales



Source: www.3g.menet.com.cn.

Fig 3: Online retail pharmacy market set to grow strongly



Source: Frost & Sullivan, Goldman Sachs Global Investment Research, Jan 2021.

prescription drug sales and price harmonisation for drugs sold online and offline. In Apr 2021, the Ministry of Commerce issued documents to support Hainan province as a pilot for online prescription sales.

Patients that suffer from chronic illnesses will benefit greatly from this move. Chronic drug sales currently make up 55% of total drug sales in China. All in, we estimate that online drug sales will experience a compounded average growth rate of at least 30-40% over the next 3-5 years. See Fig 3. The expansion of the 5G infrastructure network is also expected to improve and facilitate the quality of online consultations.

THE POWER OF AI DIAGNOSTIC SYSTEMS TO EMPOWER

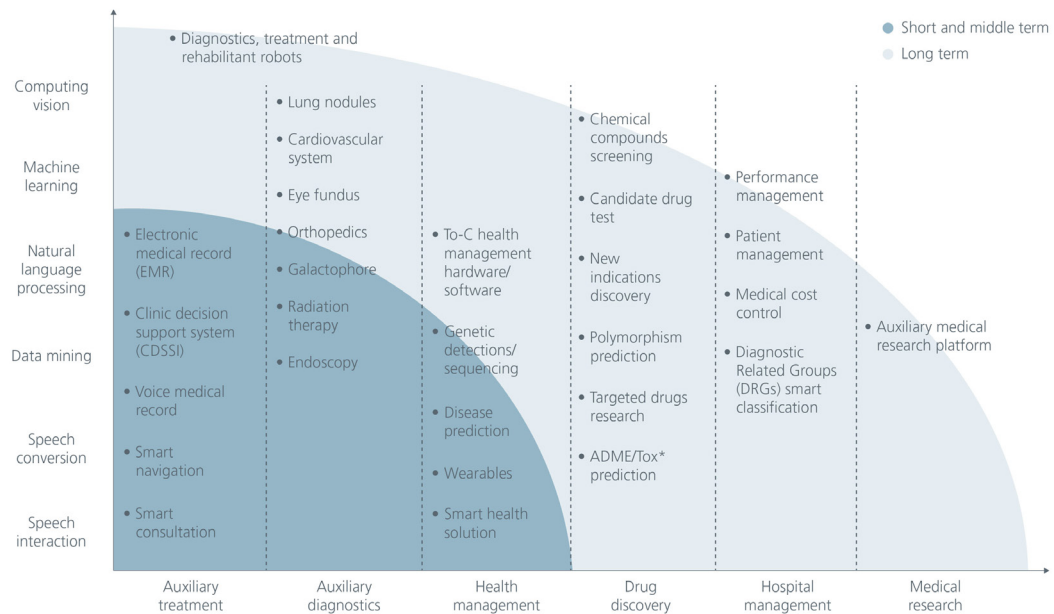
Usually a doctor makes a diagnosis based on his or her experience and scientific evidence. However, in

China's remote areas, most of the doctors are not as experienced given their lack of exposure to a range of illnesses. This is where the AI diagnostic systems created by some Chinese technology companies fit in. By using AI diagnostic systems, doctors can enhance the accuracy of a patient's disease diagnosis which results in better patient safety and survival rate. Moreover, AI tools also create value for the overall healthcare industry. Patients will have more confidence in lower tier hospitals in remote areas. In return, it will ease the traffic pressure of Grade A hospitals in high tier cities.

There are many AI healthcare companies in China; in 2020, there were 129 of them, excluding those in targeted genetic research. Among them, 55 firms are in medical imaging, representing 42.6% of the total AI healthcare players.³ Although AI technology has mostly been used in the medical imaging segment, it can eventually be more widely adopted in other healthcare areas. See Fig 4.

Source: ³<https://equalocean.com/analysis/2020082314614>

Fig 4: AI technologies' immersion in healthcare segments



Note: The ADME/Tox prediction refers to absorption, distribution, metabolism, excretion and toxicity, which is a systematic procedure to control the drug quality.

Source: EqualOcean, 2020.

INVESTMENT CONSIDERATIONS REQUIRE SOLID UNDERSTANDING

While the above narrative portends exciting investment options, it is not without challenges. For a start, investors must understand that China's healthcare industry is still a policy driven market. More than 60% of the public hospitals' expenditure is met by government medical reimbursements. As such the government's hold over the sector is strong and any policy change will impact the overall healthcare industry's growth.

Next, given the number of sub sectors within the industry, expertise of the different sub sectors is a must to single out opportunities within them. Key areas to assess a company's investment potential include the growth outlook, total addressable market size and product innovation capability.

More importantly, investors must note that not all healthcare companies are high growth ones

using cutting edge technology; there are many such as generic drug makers that have yet to embrace technology.

Meanwhile ESG is another area we need to address among healthcare investment opportunities. Here, healthtech companies face challenges related to data, namely how data is captured, stored and used. Patient records, personal information, and genetic data have different compliance requirements, making data processing a tricky business.

BIG TECH'S BIG FUTURE IN HEALTHTECH

The role of big tech companies in healthcare is expected to grow. One key indicator that shows the growing momentum in China is the integration with telehealth platforms that are being formed by insurance companies, hospitals and government. Platforms with strong supply chain capabilities are better

placed to consolidate the fragmented offline retail pharmacy market by enhancing partnerships with hospitals and quality doctors.

Separately the rapid advancement of digital technologies will promote the development of new infrastructure in digital healthcare, empowering sectors including medical services, public healthcare, drug supply, health protection and healthcare management. We are only at the start of this structural growth and as more capital is invested in these areas, higher growth will be seen.

But amidst all the euphoria, one needs to consider ethical issues. Big tech companies need to consciously show that patient care takes priority over using their data for monetisation. Data governance must keep abreast to ensure that ethical principles are adhered. Ultimately, AI technology should be an asset and not a liability for all.

This is the last of six articles in Eastspring's 2021 Asian Expert Series. In this new series which focuses on China, our investment teams offer insights into the opportunities and challenges facing China as it rolls out its 14th Five-Year Plan.

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