Healthcare - Asia Pacific

Red Sea disruptions: Implications for APAC Healthcare

Industry Overview

02 February 2024

Equity
Asia Pacific
Healthcare

Red Sea disruptions immaterial for APAC healthcare

The crisis in the Red Sea has resulted in the diversion of sea-bound freight, manufactured in the APAC region bound for Europe, around the Cape of Good Hope. This has led to longer transit times and higher shipping costs. Bulkier medical technology products are more impacted than pharmaceutical products. Overall, however, we do not expect the Crisis to have a material impact on APAC Healthcare.

Japan Medtech: Impacted but limited exposure

Given ongoing disruption in the Red Sea over the past week, we contacted medtech companies under our coverage (Olympus, Terumo, Sysmex, Asahi Intecc and PHC HD). All companies suggest minimal to no impact on their earnings at this stage but are actively monitoring the situation. Potential impact will be on transportation from Asian manufacturing sites to Europe market, but all the companies have limited exposure to this route.

AUS Medtech: CPAP shipments impact not material

Red Sea disruptions are impacting the supply route for medtech product delivery (Resmed & F&P Healthcare) to Europe (from APAC manufacturing sites). We see likely negative GM impacts via higher freight costs incurred through either longer sea freight routes and/or increased dependence on air freight. We expect higher working capital investment in inventory through higher transit times.

China Healthcare: Immaterial Red Sea impact

With respect to China Healthcare, we believe the impact from Red Sea disruptions will be minimal. China Medtech companies either have modest revenue from Europe (Mindray, United Imaging, Kangji Medical, Angelalign) or has manufacturing based in Europe (Microport CRM). Similarly leading China Pharmaceutical companies have low (ie single digit) revenue from Europe. In addition, most of the companies do not need to import products or raw materials from Europe. Huadong's medical aesthetics business, however, imports Ellanse and other medical aesthetic products from its subsidiaries in Europe. We estimate that Huadong still has enough inventory, and the short-term impact is minimal.

India Pharma: Freight cost & WC higher in near term

Ongoing disruptions in the Red Sea would lengthen transit timelines and increase costs. We expect potential freight cost increases from the Red Sea conflict, however EBTIDA margin impact should be limited (<25bpts). We see a bigger impact from increasing timeline for deliveries that could lead to higher inventory of raw materials and finished product in key markets (US). Raw material supplies from China are impacted, despite the Cape of Good Hope route (vs Suez Canal pre-conflict). This could increase working capital requirement for markets like the US, therefore leading to lower FCF in the near-term.

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Glossary:

WC: Working capital

Refer to important disclosures on page 7 to 9. 12654520

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Japan Medtech

Given ongoing disruption in the Red Sea over the past week, we contacted medtech companies under our coverage (Olympus, Terumo, Sysmex, Asahi Intecc and PHC HD). All companies suggest minimal to no impact on their earnings at this moment but are actively monitoring the situation. Potential impact will be on transportation from Asian manufacturing sites to Europe market, but all the companies have limited exposure to this route.

Our focus is largely on direct impact in shipping volume (companies' dependence on the impacted routes), shipping cost impact, and manufacturing activities. In our view, companies dealing with large-size equipment (Olympus, Sysmex and PHC HD) rely on marine transportation more than cardiovascular device companies (Terumo and Asahi), yet both Olympus and Sysmex have not been affected from the situation so far. Assuming that shipping expenses account for about 5% of the overall sales on average, a 10% increase (0.5%pt) in shipping expenses at Olympus/Sysmex/PHC HD could result in FY2025 OP impact of -2.1%/-2.7%/-6.7%, respectively, based on our OPM estimates of 24%/19%/8%. These assumptions are closer to a worst-case scenario – we think the actual damage will be much smaller.

Exhibit 2: Exhibit 1: Overseas revenue contribution data for Japan medtech companies
Approximately 20-25% of total revenue come from EU

Company name	Revenue contribution from EU	Revenue contribution from overseas
Olympus	23.41%	87.83%
Terumo	20.37%	79.19%
Sysmex	26.34%	86.42%
Asahi Intecc	18.78%	76.35%
PHC HD	23.50%	55.71%

Source: Company data and BofA Global research . Notes: The revenue contribution data of Olympus, Terumo, Sysmex and PHC HD are for FY3/24 BofA estimates, and Asahi Intecc for FY6/24 BofA estimatess.

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Australia Medtech

The Red Sea crisis is impacting the supply route for medtech product delivery to Europe from APAC manufacturing sites. We see likely negative GM impacts via higher freight costs incurred through either longer sea freight routes and/or increased dependence on air freight. Expect higher working capital investment in inventory through higher transit times.

For our coverage companies, we see ResMed as most impacted. Manufacturing is based in Singapore and Australia. The shortage of CPAP devices due to competitor's recall had led to increased reliance by RMD on air freight. The company has sought to move volume back to sea given improved supply chain reliance. The Crisis will lead to longer lead transit times and higher freight costs. This will place downward pressure on margins and upward pressure inventory levels, both of which RMD has been actively working to improve. Nevertheless, we view the impact on RMD as immaterial.

Fisher and Paykel primary manufacturing site is in New Zealand. It also has recently expanded operations in Mexico which is well located to supply the US market and also the European market given Mexico has multiple (c20) seaports on the Atlantic coast. Hence we envisage the impact on FPH as immaterial.

Cochlear and Polynovo's products are high-value, non-bulky, low volume. Avita Medical manufacturers in the UK.

China Healthcare

Immaterial Red Sea impact on China healthcare

For China medical device names, we believe Red Sea disruptions impact is minimal. For medical equipment provider like Mindray, 1) it has single digit revenue contribution from Europe market. In 1H23, only around 6% of total revenue was derived from Europe market. 2) very limited impact on margins if freight rate hikes. Shipping cost only accounted for about 1.5% of total revenue and shipping cost related to the impacted shipping route is even limited, in our view. For United Imaging, we also expect no material impact, given Europe market only accounted for 2% of its total revenue in 9M23. Moreover, the inventory of key imported raw materials could support its normal operation, even if the Red Sea disruptions has material impact and caused significant shipment delay, in our view. For Microport, although Europe market contributed around 27% of total revenue in 1H23, it was mainly derived from Cardiac Rhythm Management (CRM) business and most CRM products are manufactured in Europe. Similarly, we also believe limited or no impact on Kangji Medical and Angelalign given single digit revenue contribution from Europe market and clear aligner products from Angelalign may more rely on air freight than sea freight.

Regarding the pharmaceutical companies, we believe the Red Sea disruptions impact is also limited. The revenue contribution from EU and oversea is very low (single digit) for the leading pharmaceutical companies. And most of the companies do not need import products or raw materials from EU. Only for Huadong's medical aesthetics business, it needs to import Ellanse and other medical aesthetic products from its subsidiaries in Europe. However, with the slowdown of the medical aesthetic business in China due to the consumption downgrade trend in 2023, we estimate that the company still has enough inventory, and the short-term impact is little.

Exhibit 1: Overseas revenue contribution data of representative China healthcare companies

Most company have single digit revenue contribution from EU; while Microport has manufacturing sites in EU for EU market.

Company name	Revenue contribution from EU	Revenue contribution from overseas
Pharma/TCM		
Hengrui	NA	3.7%
CSPC	4.3%	13.9%
Sino Biopharm	NA	<10%
Hansoh	NA	<10%
Huadong Medicine	NA	3.5%
TRT	NA	6.5%
Medical device		
Mindray	5.9%	36.2%
United Imaging	2.3%	13.8%
Kangji Medical	NA	9.7%
Microport	27.4%	48.6%
Angelalign	NA	13.0%

Source: Company data and BofA Global research

Notes: The revenue contribution data of Mindray, Kangji, Mircroport, TRT, CSPC, Hansoh, SBP, Huangdong is from their 1H23 reports. Hengrui's revenue contribution is from its 2022 annual report. United Imaging's data is from its 9M23 report material. Angelalign's data is estimated via its 2023 case shipment data.

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India Pharma

As most India pharma companies are exporters (~60-70% of revenue for most large caps) and are also dependent on imports from China for APIs/intermediaries/ KSMs, the ongoing disruption in Red Sea would impact transit timelines and cost. While companies have indicated freight cost increase from the Red Sea conflict, the impact to EBITDA margins would be limited (<25 bps). The bigger impact would be from increasing timeline for deliveries that could lead to higher inventory of raw materials as well as finished product in key markets like US for upcoming launches.

While raw material supplies from China should be impacted by conflict, companies indicated fewer ships coming to the ports of western India given the detour as they are now using the route around the Cape of Good Hope (vs Suez Canal before the conflict). This could increase working capital requirement for markets like the US, therefore leading to lower FCF in the near-term. We would however, point out that most India companies have strong FCF generation and net cash balance sheet. DRRD for instance, reported FCF of Rs200Mn in Dec-23 qtr vs. Rs14Bn last qtr (on flattish EBITDA) but has ~Rs60Bn net cash on its books. The company in-fact called out its competitive advantage from the rich balance sheet enabling it to better service customers vs. players with lower cash buffer (i.e. leveraged US generic companies).

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