InCred Asset Management

INCRED HEALTHCARE PORTFOLIO

Aditya Khemka
Fund Manager

- Over 16 years experience in Equity businesses and investments. Brings along a rich global working experience in the US, EU, Latin America and in India.
- Has performed various roles like Treasurer in Glenmark (2006-2007), institutional equities analyst for Lehman, Nomura and Ambit Capital (2008-2015) and Healthcare fund manager for DSP (2015-2020).
- Qualifications - MSc. (Finance), PGDM (MDI, Gurgaon), CIIA (UK), CFA (ICFAI).
- Have formulated and executed a product strategy in DSP that drove ~40% alpha over the benchmark in 18 months with low churn and highest Sharpe ratio amongst peers.
- Believes in bottom-up research and understanding the source of cash flows and their sustainability.

Secular vs. Cyclical – Story with Different Endings

An average Large cap Indian Pharma company in FY22

In Rs.	Indian business	US business	API/ROW	Consolidated
Revenue	30.0	50.0	20.0	100.0
EBITDA	12.0	5.0	5.0	22.0
Depreciation	0.5	6.0	0.5	7.0
Interest income	2.0	-	0.5	2.5
Interest expense	-	5.0	-	5.0
PBT	13.5	-6.0	5.0	12.5
Tax	2.0	-	1.0	3.0
PAT	11.5	-6.0	4.0	9.5
Capital Employed	25.0	50.0	25.0	100.0
RoE	46%	-12%	16%	10%
Multiple at CMP	**20 PE**			
Price of stock	**190.00**	**(20x9.5)**		

Same example without US business in FY22

In Rs.	Indian business	US business	API/ROW	Consolidated
Revenue	30.0		20.0	50.0
EBITDA	12.0		5.0	17.0
Depreciation	0.5		0.5	1.0
Interest income	2.0		0.5	2.5
Interest expense	-		-	-
PBT	13.5		5.0	18.5
Tax	2.0		1.0	3.0
PAT	11.5		4.0	15.5
Capital Employed	25.0		25.0	50.0
RoE	46%		16%	31%
Multiple at CMP	**25 PE**	(higher due to >30% ROE)		
Price of stock	**387.50**	**(25x15.5)**		

Source: Internal Compilation

- The Indian Pharma Market (IPM) is a secularly growing segment with extremely high RoE due to the brands owned by pharma companies. We expect the market to continue to grow at 8%-10% in sales and mid to high teens in profits
- US generic market has gone through an earnings downcycle over past 4 years and has seen signs of earnings recovery. Better pricing and gain in volumes as competition may get crowded out could lead to better RoE of the business in coming years
- A 'valuation-gap' exists today in many companies where the poor RoE of US business is suppressing the overall RoE and valuation multiples. We expect this to reverse as US generic profitability improves
- We believe the consolidated valuation as of now lends a negative valuation to the capital guzzler (US generics) implying that this business may never turn positive and losses in the business may compound over time. This is highly unlikely and also unreasonable.

Current valuations imply a negative valuation for the US generics business. Giving a '0' value to this lossmaking business and ascribing higher multiple to the stable domestic business (with higher RoCE) may translate to meaningful upside in relevant stocks.

IPCA Investment Strategy

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(INRm)	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21
Domestic Sales	9,294	11,287	11,667	13,886	14,254	16,468	19,126	24,510
PAT	1859	2257	2333	2777	2851	3294	3825	5825
Domestic EPS	14.8	17.9	18.5	22.0	22.6	26.1	30.4	46.0
ex-DF sales	23,524	20,127	17,004	17,681	18,324	20,989	27,361	32,059
PAT	2931	281	-1402	-771	-710	854	2787	6800
ex-DF EPS	23.3	2.2	-11.1	-6.1	-5.6	6.8	22.1	46.5
Total EPS	38.0	20.1	7.4	15.9	17.0	32.9	52.5	92.5

- IPCA stock price fell ~50% by Aug-17 from highs of Feb-14 due to import alert in US business.
- While overall EPS for FY16 came in at Rs 7.4 (Rs 38 in FY14), the domestic business continued to deliver ~11% earnings CAGR. It was the ex-DF business which contributed negatively to the earnings.
- Our investment thesis was built around high conviction in the domestic business and international business to cut losses eventually. Domestic business delivered 13% earnings CAGR for FY16-18 while international business (ex-US) reached pre-import alert profitability. IPCA significantly cut opex for its US biz during this time.
- Stock was up 3x in Mar-20 from the lows of Mar-16

Source: Internal Compilation

The above company is for illustration purposes only for explaining the above concept. The company mentioned above may or may not form part of the Investment Approach/Product.

Why Indian Healthcare ?

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Unbranded Generics — Pricing pressure, regulatory issues and low RoEs sustaining for now

- Pricing pressure, low RoE and regulatory issues in US market makes it an avoidable investment for now. However, there are certain pockets of interest (deep value).
- China which is largely dominated by MNCs (~85% ms) is now looking at Indian companies to introduce generics (China market size USD150bn). This is an optionality and would likely play out in the long term.

Branded Generics — High margin, low capex & steady cash flow business

- Branded generics has high sustainable cash flows, low capex & high RoE with high barriers to entry (8-10% growth & 40%-80% RoE)
- Increasing lifestyle related diseases, better diagnostics and affordability driven by Ayushman Bharat (affordability to expand from 150-200m individuals to 500-600m individuals over time)

APIs/CDMO/CMO — 'China + 1' a huge boost to API players

- Anti-China rhetoric could play out well for Indian API players. China exports ~USD30b worth of APIs vs ~USD4b from India. A 10% shift in demand can double India's API industry size.
- Given noncompliance to ESG and recent supply disruptions, Big Pharma is also looking at diversifying sourcing beyond China.

Hospitals — Capex phase largely over; time to monetize

- Indian hospital players have incurred huge capex to increase capacity which is coming to an end (Mature hospitals RoE at ~20% vs consolidated 4%-12%)
- This may lead to better margins, cash flows and lower debt resulting in re-rating of the business.

Diagnostics — Low penetration to benefit organized players

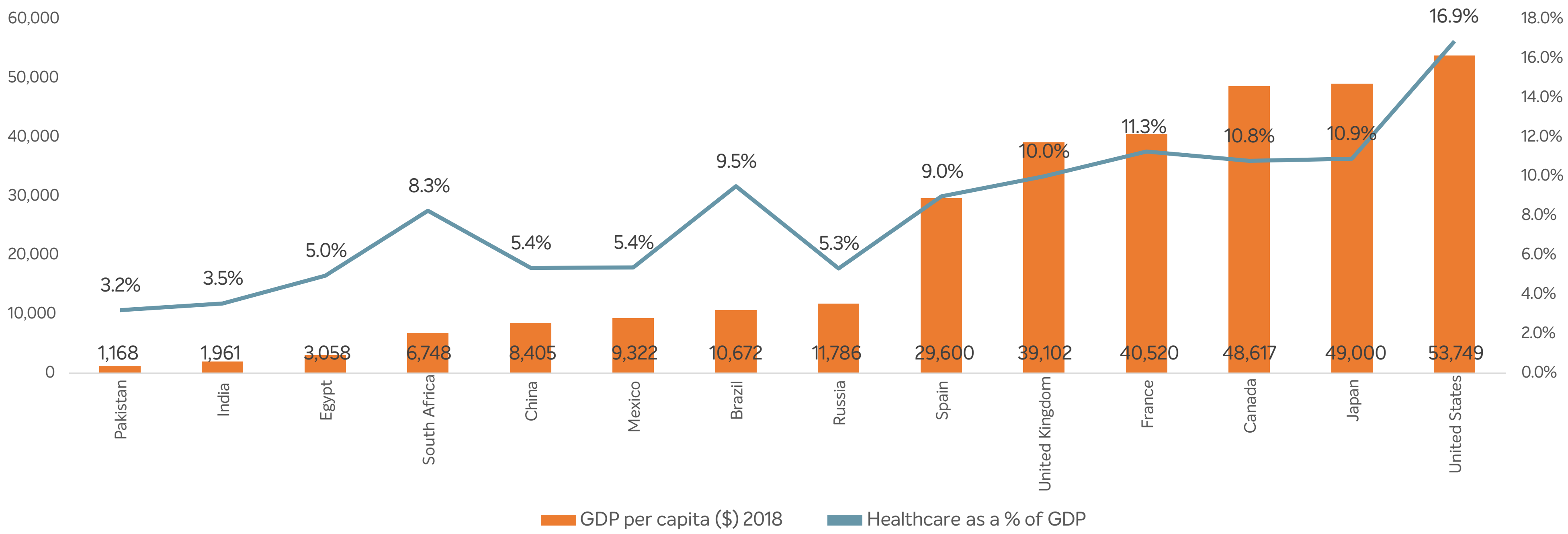
- Diagnostics is 85% being unorganized. With increase in health awareness, the organized players are expected to benefit the most.
- Broader market growing at 10% pa and organized gaining share. High RoE and low reinvestment needs.

Source: IQVIA, KPMG report, Internal

GDP & Healthcare Correlation

We observe that as GDP per capita increases, healthcare spend increases significantly. Developed economies have a very high expenditure on Healthcare as % of GDP vs developing economies.

This gives us comfort that there is significant headroom for growth in this sector for India.



Source: World Bank

GDP & Healthcare Correlation

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15 yrs at 10% GDP growth

GDP per capita: USD 9,000

GDP per capita: USD 2,000

India

Brazil

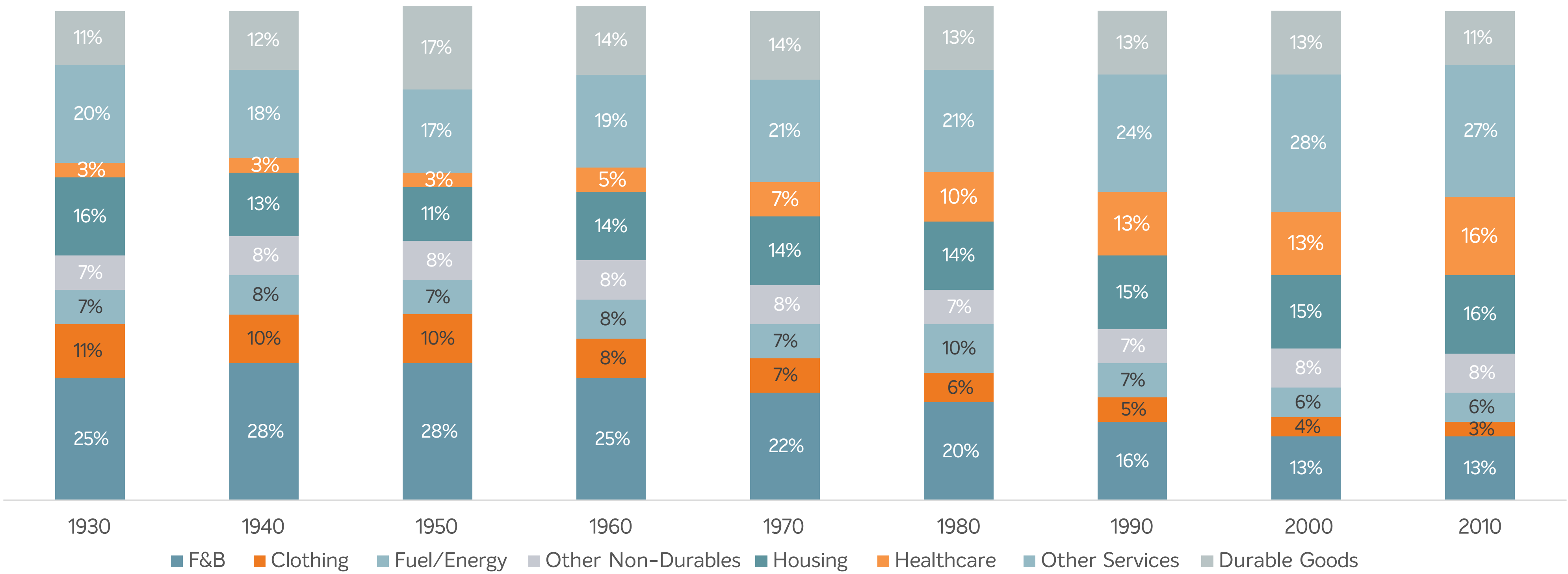
Healthcare spend per capita: USD73

Healthcare spend per capita: USD848

For India to equal Brazil's healthcare per capita spend, the industry must grow at 18% over the next 15 years

Source: World Bank

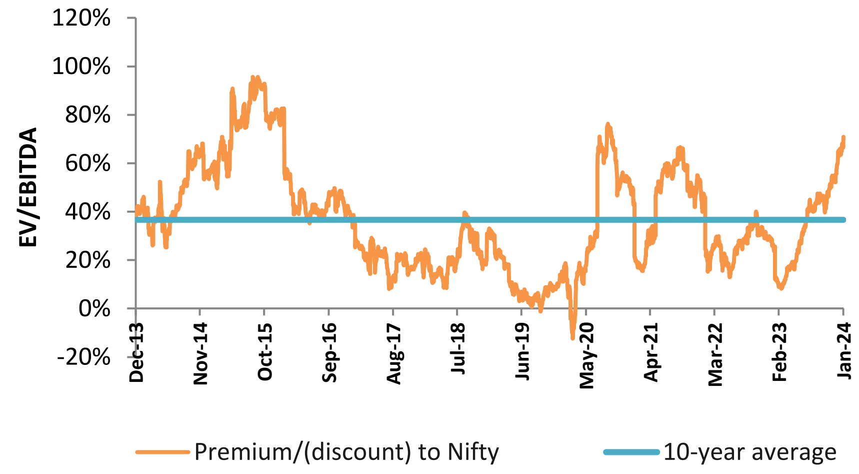
Healthcare Growth Faster Than Economy

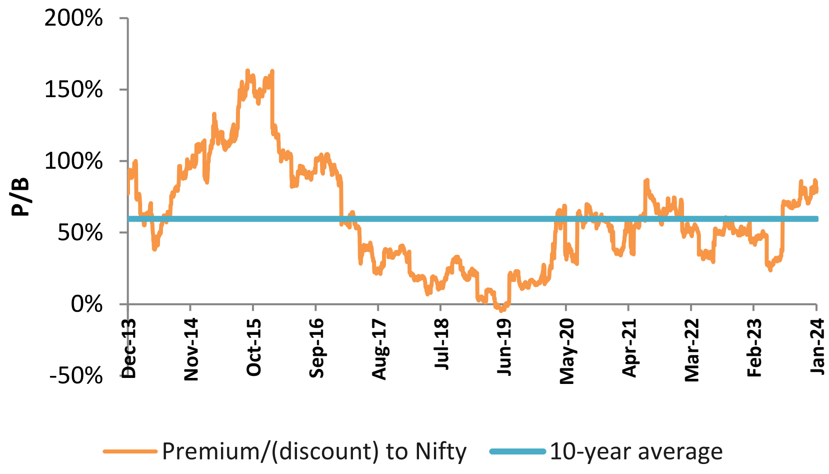


- In the US, Healthcare grew much faster than other sectors over the last century
- India current healthcare spend per capita is 3.5% of the GDP per capita which is where the US was in 1930's-1950's. We see huge runway for growth in healthcare as GDP per capita rises over the next few decades.

Source: Industry

Valuations below 10-yr average

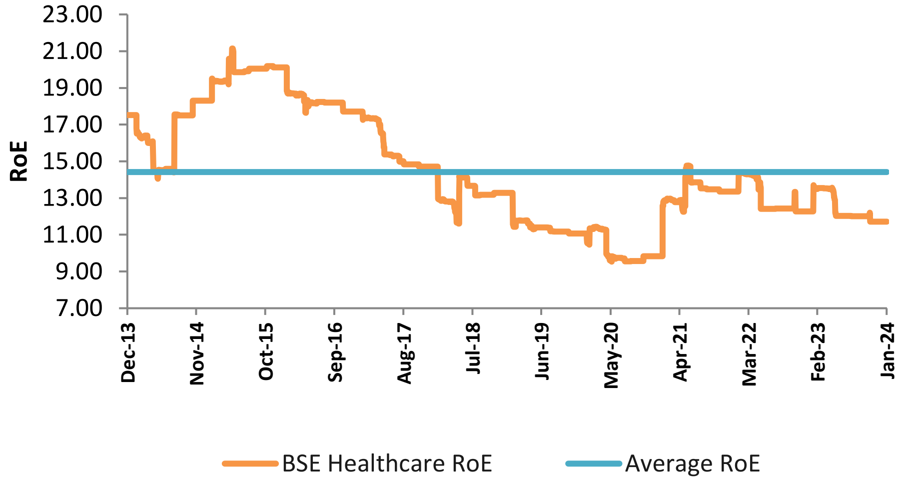




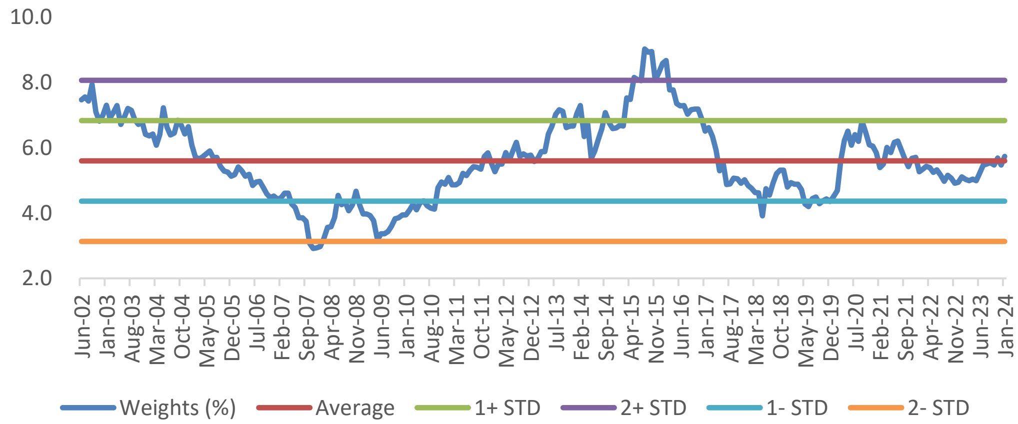
Trading at 71% premium to Nify vs 10–yr avg. of 37%

Trading at 81% premium to Nify vs 10-yr average of 60% and peak premium of 163%

Improvement in business and ROE may lead earnings growth and rerating of the sector going forward



Healthcare Weight in NSE 500 (m-o-m) in %



Source: Bloomberg | Data as on 31st January 2024 | * EBITDA – Earnings before Interest, Taxation, Depreciation and Amortization

Healthcare not a Sectoral Call

Is a Healthcare PMS allocation a sectoral call? – We believe NOT.

How much should one allocate? – 10%-15% of equity portfolio is justified.

- Healthcare portfolio offers a solution that invests in 5 baskets of businesses.
- Upon closer examination, one can deduce that the portfolio in itself is a multi-cap diversified equity portfolio with exposure to 5 segments. The only difference is that consumption in healthcare in non-discretionary and secularly growing, whereas for these analogies, consumption is discretionary.

% of portfolio in	Same economic model as*	Avg. Of competing funds (%)	BSE Healthcare (%)	Incred Healthcare PMS (%)
Hospitals	Branded Apparel Retail	14.7	16.3	9.5
Diagnostics	Quick service Restaurants	2.3	2.0	21.2
Generics	Metals and commodity	45.3	44.5	-
API	Chemicals, Industries	8.4	12.9	22.4
Branded Generics	FMCG	24.3	24.3	37.2
Others		5.2	-	9.7
Grand Total		100	100	100

Capitalisation	Weight
Large Cap	~20%
Mid Cap	30%-40%
Small Cap	40%-50%

Healthcare is a sector in India, where the companies that you invest, are globally competitive.

Data Source: Computation: Internal. *Segments defined by InCred Healthcare Fund Manager
*To read on our thesis for like-to-like comparison, please refer slide 12. The above comparison is being provided for informational purposes, for model client vis-a-vis thematic mutual funds following healthcare and pharma theme as on 31st December. The comparison is being provided for said 5 different healthcare sector segments, as defined by Fund Manager, to depict overweight/underweight stance under InCred Healthcare portfolio

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Our thesis for like-to-like comparison

Hospitals	We believe that hospital companies work on similar business model as apparel retail segment, where hospitals have to open new units, track performance of existing hospitals and have similar economics as retail stores
Diagnostics	Just like QSR companies where per store economics, opening of new stores, etc. matter, diagnostic companies too have to open new centers, expand into newer markets
Unbranded Generics	In unbranded generics demand-supply determines the price, and hence we believe these companies do not have pricing power; similar to metals and commodity companies
API	Similar to industrials, API companies have huge capacity, higher utilization improves operational efficiencies, scope for China +1 strategy, have global cost leadership
Branded Generics	Branded generics is being considered like FMCG, as patients tend to prefer brands of reputed companies, have large distribution channel, have pricing power, marketing and promotional activities can drive sales

The above comparison is being provided for informational purposes, for model client vis-à-vis thematic mutual funds following healthcare and pharma theme. Data Source: Computation: Internal. The comparison is being provided for said 5 different healthcare sector segments, as defined by Fund Manager, to depict overweight / underweight stance under InCred Healthcare portfolio. Please refer disclaimers on next page

A Diversified Sector

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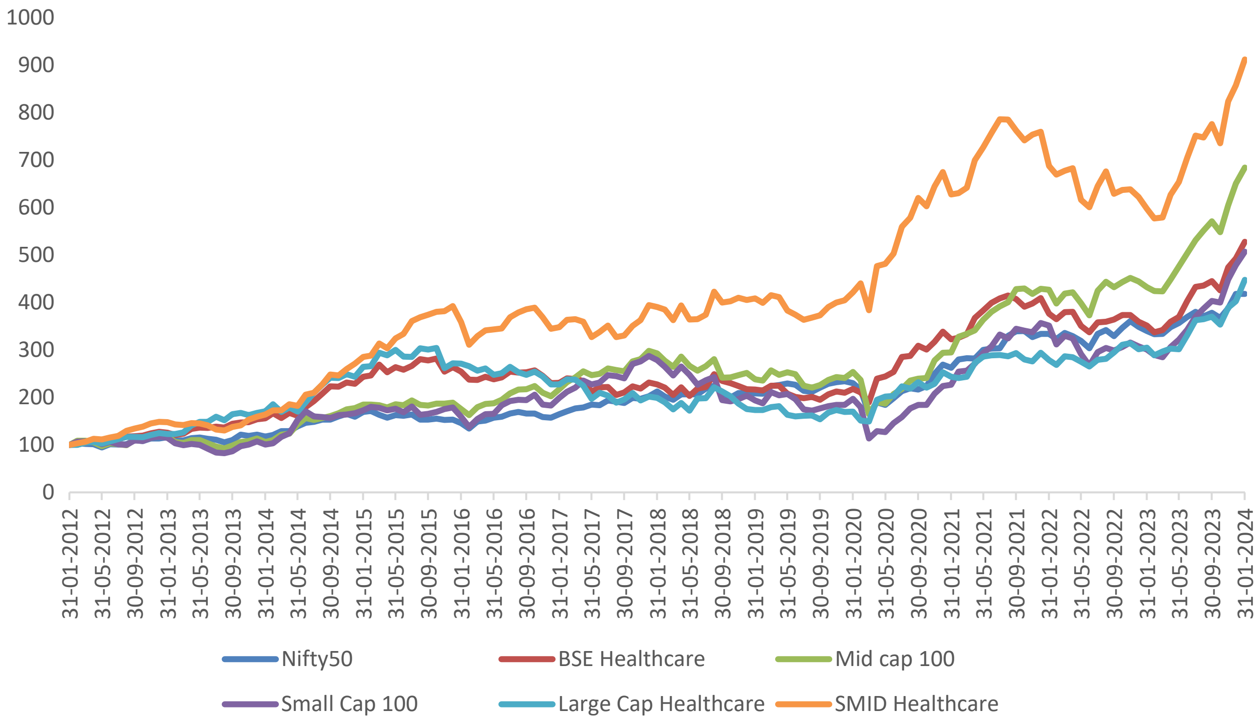
OCF Correlation	DRL	Torrent	Divis	Apollo Hospitals	Dr Lal	HUL	Ultratech Cement	Infosys
DRL	1.00	0.87	0.85	0.79	0.81	0.73	0.78	0.78
Torrent	0.87	1.00	0.71	0.61	0.64	0.55	0.57	0.60
Divis	0.85	0.71	1.00	0.86	0.96	0.89	0.92	0.91
Apollo Hospitals	0.79	0.61	0.86	1.00	0.93	0.93	0.95	0.92
DrLal	0.81	0.64	0.96	0.93	1.00	0.97	0.95	0.98
HUL	0.73	0.55	0.89	0.93	0.97	1.00	0.92	0.98
Ultratech Cement	0.78	0.57	0.92	0.95	0.95	0.92	1.00	0.94
Infosys	0.78	0.60	0.91	0.92	0.98	0.98	0.94	1.00

*OCF- Operating Cash Flow

Healthcare Outperformance

Is a Healthcare PMS allocation a tactical call? – We believe NOT.



- Since 2012, the BSE Healthcare Index has outperformed Nifty by ~110%

- Large cap healthcare companies outperformed
- Nifty50 (+29%), while underperformed BSE healthcare (-81%) during the same period.

- SMID Healthcare stocks have outperformed Nifty50 by 494% and BSE Healthcare by 384% during the same period.

Source: Investing.com; *We have defined stocks above INR 100bn market capitalization as large cap and rest of the companies as mid and small cap
Data from Jan-12 to Jan-24

US: A Treadmill Segment

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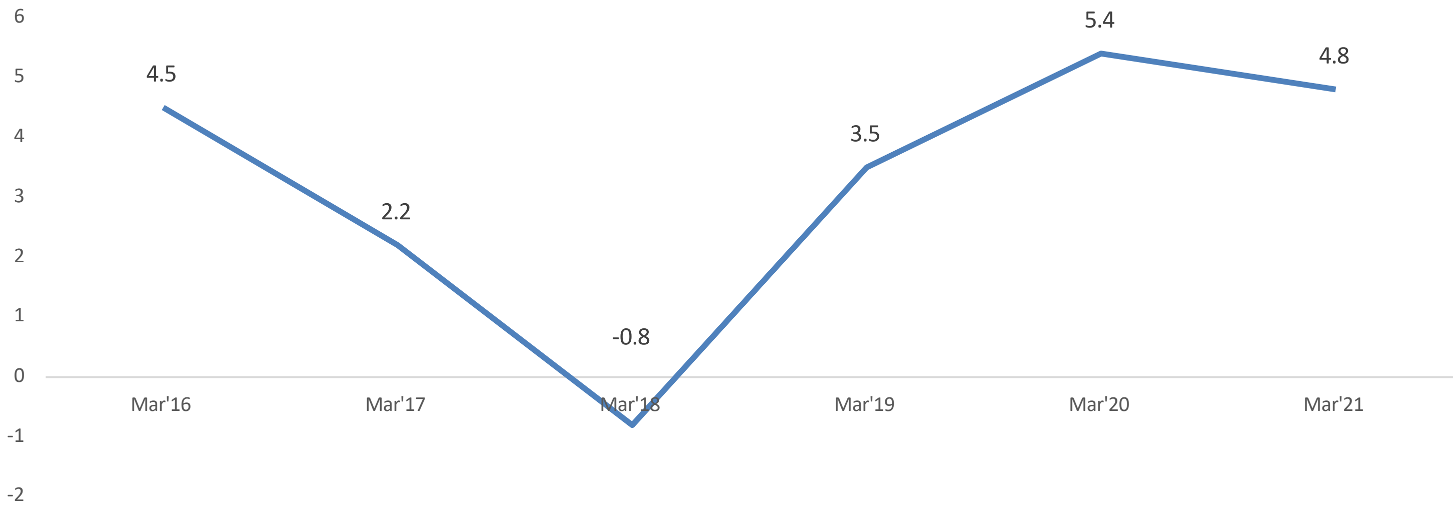
US Generic Price Erosion (%)

Source: IQVIA

Domestic Price Growth (%)



Source: AIOCD

Next Downcycle a Decade Away

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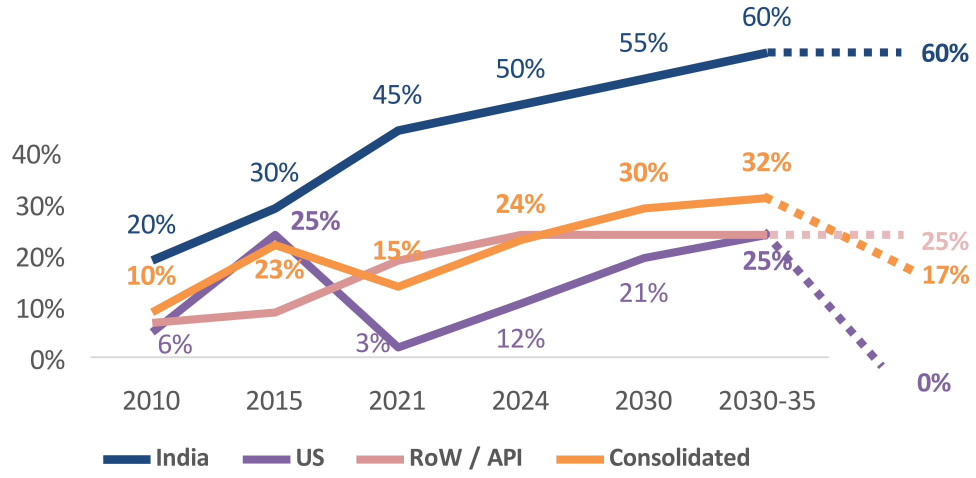
- Many investors believe that healthcare is a cyclical play taking cues from the upcycle between 2009-2015 and the downcycle thereafter. We dig deeper and try to address the concern!

- What happened? We discern that downcycle post 2015 started when US business RoEs reached ~25% levels. This is when the industry attracted high level of competition. Consequently, RoEs started to plummet, with US RoEs dropping to ~3% levels in FY21. Thus, BSE Healthcare peak RoE of 23% in FY15 fell to 15% in FY21

- How is it different this time? We notice that, while in 2015, RoEs of India business stood at ~30%, they were much better in FY21(~45%) and we expect them to peak out at ~60% levels somewhere around FY30-35.

  We also expect US to improve from ~3% to ~25% by then

- How it matters? With increased RoEs from India business, the consolidated RoE uptick this time may be much more immune. Thus, when US RoEs reach ~25% in 2030-35, and start to see a downcycle, the subsequent RoE impact may be much lower. According to our estimates, even if US RoEs go to zero, the overall RoEs might still be ~17% (~15% in FY21). *<u>Even in a worst case scenario, RoEs should be better than what they are today!</u>*



Decision Making Process

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Buy

- "Great" business at fair price
- "Good" businesses at discounted value vs intrinsic value
- Avoid "Bad" businesses

Sizing

- Optimal diversification
- Allocation base on conviction

Sell

- When incremental Upside-Downside ratio is unfavorable
- When the underlying business starts to deviate from the investment thesis

Framework Examples

Our Criteria	TORRENT	IPCA	DIVIS	AJANTA	SYNGENE	THYROCARE	JB CHEM	ALKEM	INDOCO
Quantitative									
RoIC v/s WACC	√√√	√√	√√√	√√√	√√	√√√	√√√	√√√	√√
Capital Structure	√√	√√√	√√√	√√√	√√√	√√√	√√√	√√√	√√√
Cash Flow Adequacy	√√√	√√√	√√	√√	√√√	√√√	√√	√√	√√√
Covenants	√√√	√√	√√√	√√√	√√√	√√√	√√√	√√√	√√
Growth	√√√	√√√	√√√	√√√	√√√	√√	√√	√√√	√√
Qualitative									
Competitive Advantage	√√√	√√√	√√√	√√√	√√√	√√	√√	√√	√√√
Pricing Power	√√√	√√√	√√√	√√	√√	-√√	√√	√√	√√
Character of Management	√√	√√√	√√	√√√	√√√	√√	√√√	√√√	√√
Alignment of Interest with Minority	√√√	√√	√√	√√	√√	√√√	√√√	√√	√√√
Dependence of External Variables	√√	√√	√√	√√	√√	√√	√√	√√	√√
Score	**27**	**26**	**26**	**26**	**26**	**21**	**25**	**25**	**24**

Maximum score can be 30

A score of 3 is granted if the company fulfills the Great Business parameters listed in the last slide. A score of 2 is given if the company fulfills the Good Business parameters and -2 is for Bad Business

ROIC : Return on Invested Capital; WACC Weighted Average Cost of Capital. The above examples are for illustration purpose only.
The companies mentioned above may or may not form part of the Investment Approach/Fund/Scheme.

Portfolio Fundamentals

INR mn	FY21	FY22	FY23	FY24E	FY25E	FY21-25E (%)
Total Sales	19,570	21,605	24,000	26,869	30,571	12
Growth yoy (%)		*10.4%*	*11.1%*	*12.0%*	*13.8%*	
EBITDA	5,029	4,929	4,615	5,598	6,888	8
Growth yoy (%)		*-2.0%*	*-6.4%*	*21.3%*	*23.1%*	
EBITDA Margin (%)	*25.7%*	*22.8%*	*19.2%*	*20.8%*	*22.5%*	
PAT	2,614	2,528	2,076	2,600	3,524	8
Growth yoy (%)		*-3.3%*	*-17.9%*	*25.2%*	*35.5%*	
PAT Margin (%)	*13.4%*	*11.7%*	*8.7%*	*9.7%*	*11.5%*	
RoCE	16.4%	13.6%	10.7%	13.2%	16.2%	
Valuation Ratios						
P/B	6.8	5.9	5.6	5.1	4.6	
EV/Sales	5.9	5.4	4.9	4.4	3.8	
EV/EBITDA	23.1	23.6	25.4	21.0	16.8	
P/E	43.1	44.5	54.2	43.3	31.9	
OCF yield	4.0%	3.0%	3.4%	3.8%	4.4%	
FCFF yield	2.7%	1.3%	1.1%	0.9%	2.6%	

Portfolio expected to see 12-14% revenue growth over the next two years. While margins to contract by ~320bp over FY21-25E, it is expected to improve by ~330bps over two years

Portfolio earnings growth expected ~8% CAGR (FY21-25E), however expect PAT to grow by 25-35% for FY24E & FY25E.

Valuation on forward basis at P/E 32x 2yr forward

EBITDA : Earnings before Interest, Tax, Depreciation and Amortization;
RoCE : Return on Capital Employed;

Disclaimer: Expected portfolio fundamentals; Source: Internal Compilation; Portfolio excluding Insurance companies and UPL

Portfolio Performance

	IHP*	S&P BSE 500 TRI	Alpha (BSE 500 TRI)	BSE Healthcare Index	ALPHA (BSE Healthcare Index)
1 Month	2.3%	1.9%	0.4%	7.2%	-4.8%
3 months	12.9%	17.9%	-5.0%	24.0%	-11.1%
6 Months	22.2%	16.2%	6.0%	22.1%	0.0%
1 Year	52.1%	33.4%	18.6%	51.4%	0.6%
2 Year	19.9%	16.5%	3.4%	19.3%	0.6%
Since Inception	16.6%	18.1%	-1.5%	16.5%	0.1%

*IHP- InCred Healthcare Portfolio is offered under Equity Strategy in terms of SEBI circular dated Dec 16, 2022. Benchmark Index: BSE 500 TRI. Inception date of IHP: 15th February 2021. Data as on 31st January 2024. **Past performance may or may not be sustained in future and should not be used as basis for comparison with other investments.** Returns are composite of all the Portfolios aligned to the investment approach. Returns for individual client may differ depending on the timing of inflows and outflows of funds and/or differences in the portfolio composition because of restrictions and other constraints, if any. Returns for 1 year or lesser time horizon are absolute returns. Where last 3,4,5 year performance returns are not available, they have not been shown. Returns have been calculated using Time Weighted Rate of Return method (TWRR) as prescribed by the SEBI. Performance figures are net of all fees and expenses. The performance related information provided herein is not verified by SEBI nor has SEBI certified the accuracy or adequacy of the same. For performance details of other Portfolio Managers for similar strategy, please refer to https://www.apmiindia.org/apmi/welcomeiaperformance.htm?action=PMSmenu.

Portfolio Details

Top 10 Holdings

KRSNAA DIAGNOSTICS LTD	11.1%
RPG LIFE SCIENCES LTD	11.0%
JUBILANT PHARMOVA LTD	10.8%
THYROCARE TECHNOLOGIES LTD	10.1%
HEALTHCARE GLOBAL ENTERPRISES LTD	9.5%
SYNGENE INTERNATIONAL LTD	6.8%
FDC LTD	5.7%
HIKAL LTD	4.8%
IPCA LABORATORIES LTD	4.6%
AJANTA PHARMA LTD	4.2%

Market Capitalization

	IHP*	BSE Healthcare
Large cap	8.1%	43.1%
Mid cap	19.9%	32.0%
Small cap	72.0%	24.9%

Business Segment Breakup

	IHP*	Relative Weight
Branded Generics	37.2%	Overweight
API	22.4%	Overweight
Diagnostics	21.2%	Underweight
Hospitals	9.5%	Overweight
Others	8.4%	Overweight

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Thank You