

S&P Healthcare Credit Beat: Ratings Outlook 2024

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Stable Amidst Improving Conditions, but Deterioration Still at Low End Through 1H24

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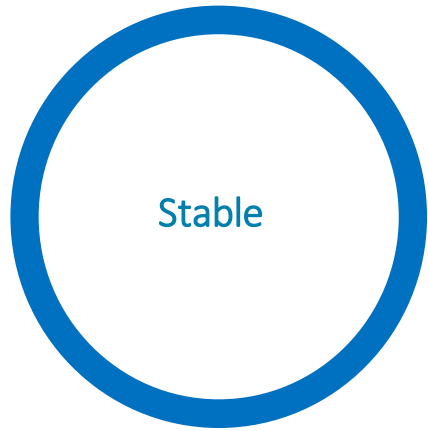
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U.S. Healthcare | Agenda

- Ratings outlook for healthcare and its subsectors.
- Major industry themes we are watching, and what it means for ratings overall.
- Thoughts on the major subsectors.
- Discussion on:
 - Labor market
 - Concerns on reimbursement
 - Legislative developments
 - M&A in speculative grade healthcare
 - GLP-1s

U.S. Healthcare Sector Ratings Outlook: Stable

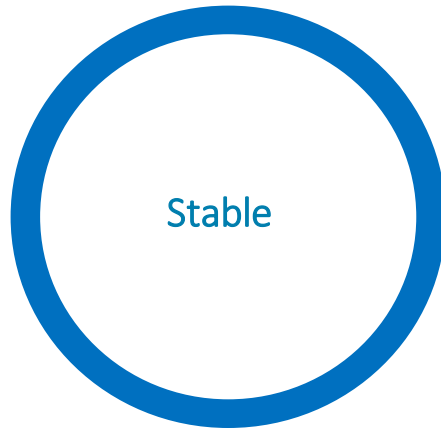
Stable on four of five major subsectors, Healthcare Services remains **Negative**.



Stable

Pharmaceuticals

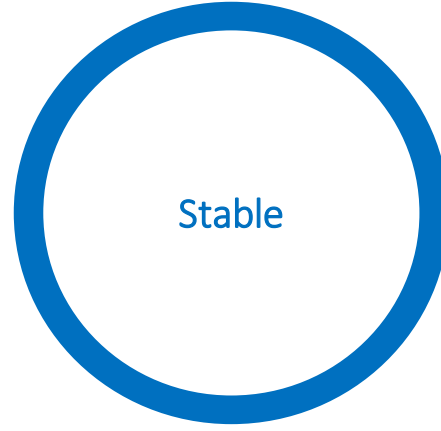
Return of M&A, Inflation Reduction Act, Inflation Reduction Act, increased pricing pressure, return of M&A



Stable

Medical Devices and Life Sciences

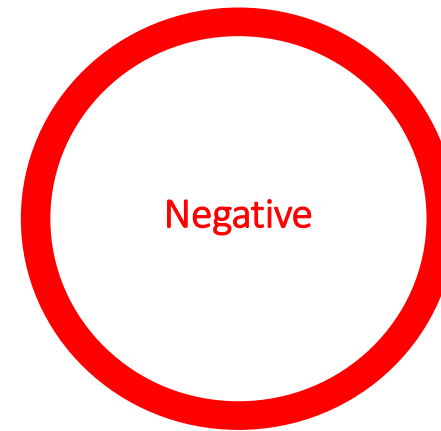
"Most" stable of subsectors, procedure backlog has been worked through.



Stable

HC Business Services/IT

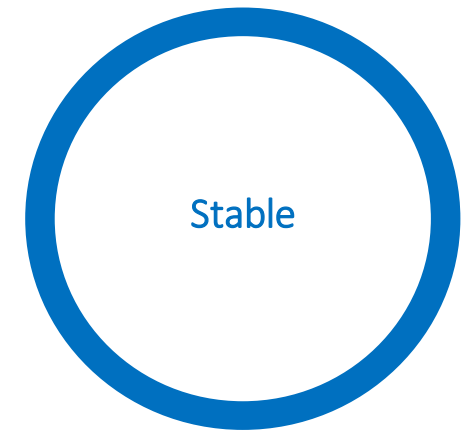
Distributors, CROs, and Healthcare IT; mixed group, largely stable.



Negative

Healthcare Service Providers

Labor and inflationary pressures moderating, but relative low visibility of sustainability of positive cash flows, No Surprise Act, interest expense on group with elevated leverage.



Stable

Health Insurance

Revenue growth driven by rate increases, though Medicare Advantage and healthcare cost headwinds.

U.S. Healthcare | Top industry talking points for 2024.

Ratings outlook stable, but ratings deterioration will continue for healthcare services/speculative grade group.

- Demand and conditions improved, but low rated credits will drive downgrades at least through first half of 2024.
- Visibility on sustained cash flow generation and sustainability of capital structures still cloudy for many low rated credits.

Healthcare demand has normalized.

- 2024 will be first full “pure” year.
- Patients and procedure volumes, acuity normalized.

Healthcare labor remains top concern.

- Improvements in labor market, but still elevated growth rates.
- Structural shortages remain a long-term challenge.

Reimbursement environment concerns rising.

- We do not think reimbursement environment is going to be as benign as 2023.
- Rising medical cost ratios and rising employer healthcare costs.

U.S. Healthcare | Top industry talking points for 2024.

Return of M&A

- Expectations of continued M&A in pharma, but also increasing in medical devices, life sciences, and healthcare services.

Legislative noise/concerns increasing.

- Medicare Advantage, No Surprise Act, Medicaid re-determinations, site neutrality, IRA, PBM transparency, FTC.
- U.S. presidential election year.

Speculative grade healthcare remains vulnerable.

- Labor costs, No Surprise Act, high interest costs have sapped free cash flow generation.
- Healthcare defaults at record levels.
- When does private equity resume roll-ups?

GLP-1s.

- Do costs of GLP-1s overwhelm system?
- Ratings impact for various subsectors.

U.S. Healthcare | What does it mean for Healthcare ratings in 2024?

Return of M&A increases pressure on ratings.

- Expect increased M&A activity in medical devices, life sciences, and healthcare services, pharma remains active.
- Pharma, med device, and life sciences do have significant capacity within current ratings for M&A.

Healthcare ratings to continue to deteriorate through 1H24 but concentrated in low speculative grade and in healthcare services.

- No Surprise Act impact, labor costs, and interest expense should moderate, visibility to improve by 2H24.
- Potential for stable outlook on healthcare services later in year?

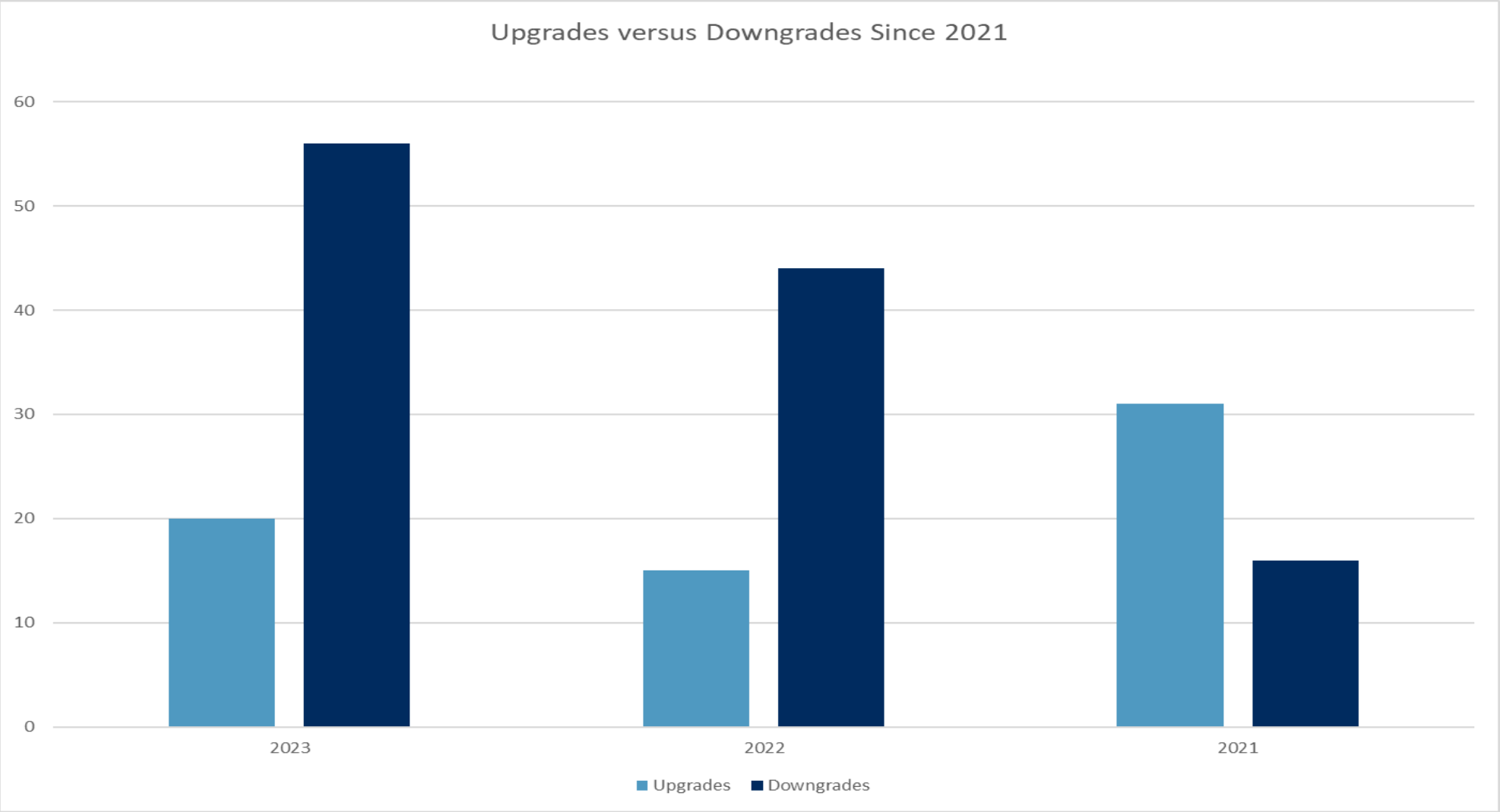
'CCC' Bucket – “Capital Structure Unsustainable” – to grow.

- Remain in 'CCC' even after addressing maturity walls.
- Low visibility on cash flows for low speculative grade credits.
- Defaults remain elevated, but will be down from 2023.

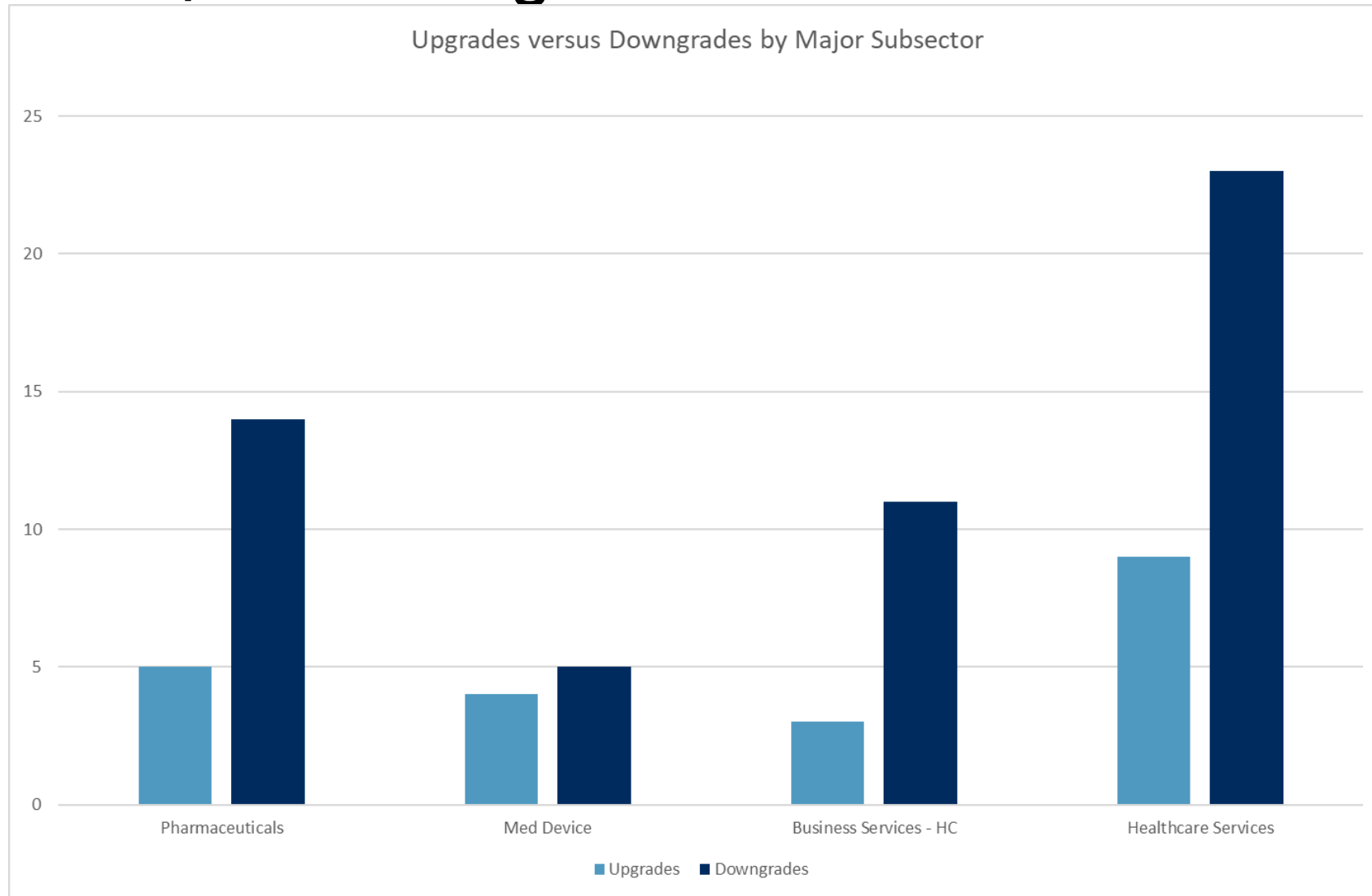
Negative ratings bias, at near five year high, should moderate.

- Improved visibility, performance should lead to more ratings stability by second half of 2024.
- Adjusted EBITDA margins though have still yet to recover.

U.S. Healthcare | Ratings Deterioration Going on Two Years

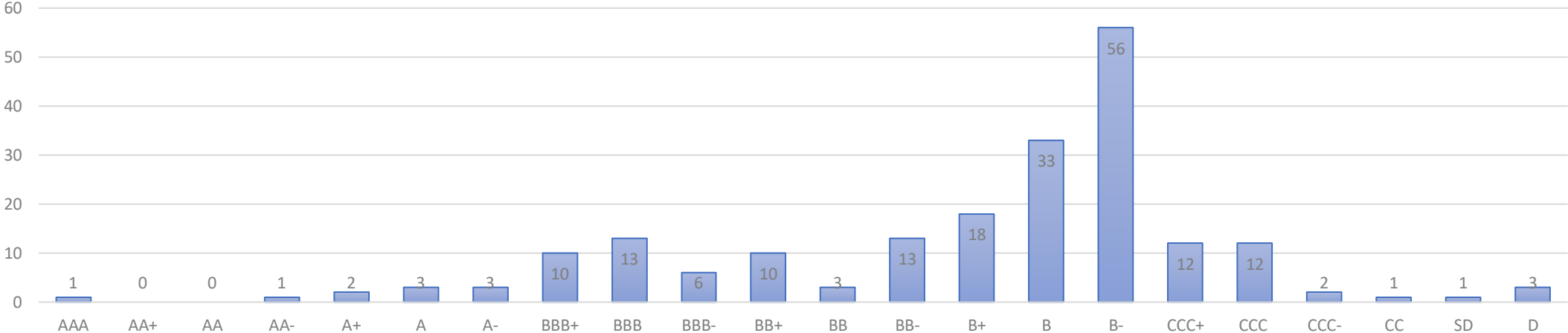


U.S. Healthcare | 2023 Ratings Deterioration Across All Subsectors

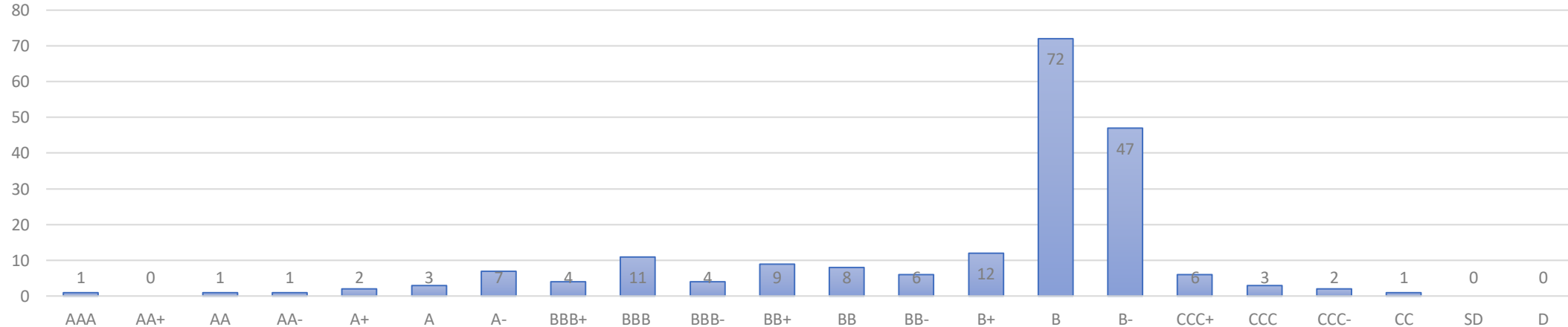


U.S. Healthcare | Ratings Deterioration Over Past Four Years

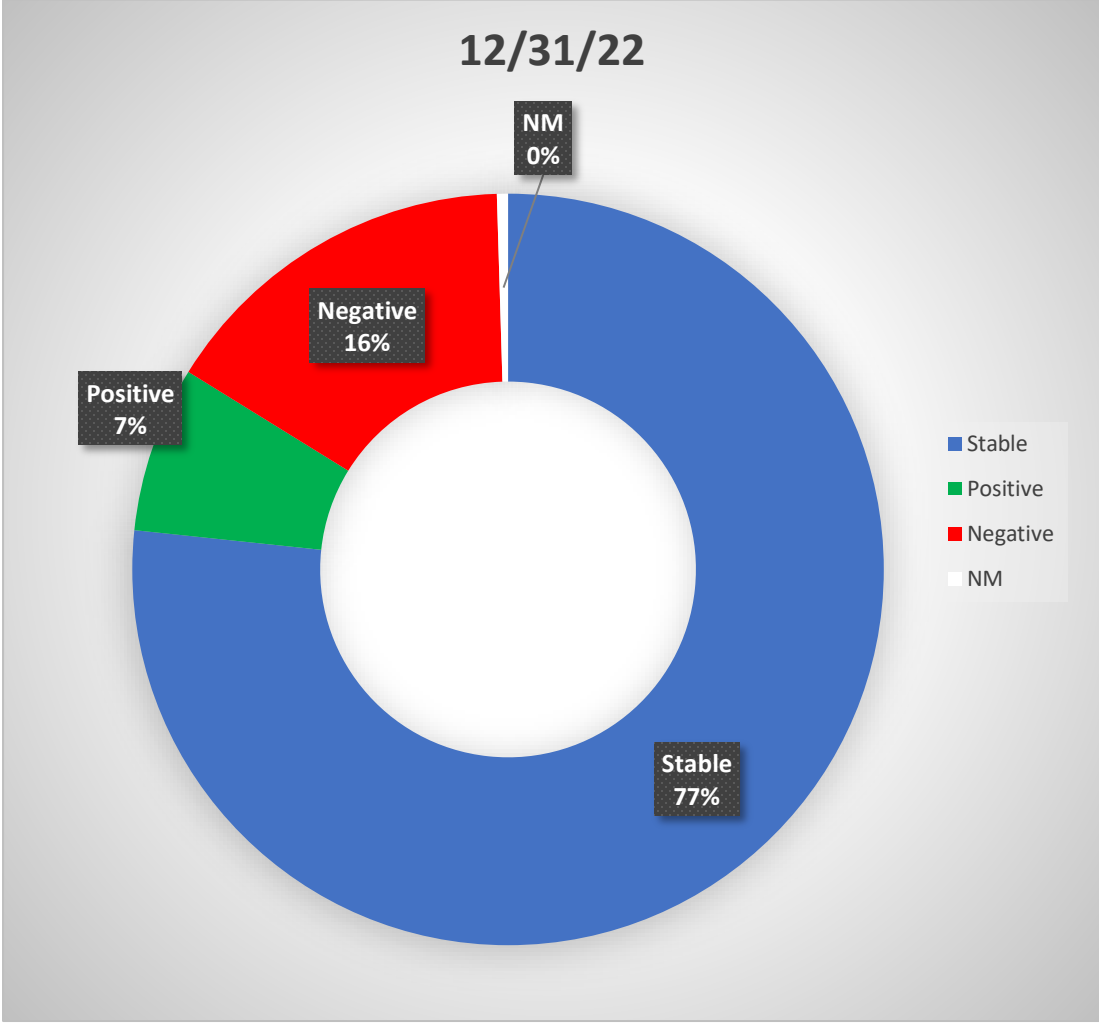
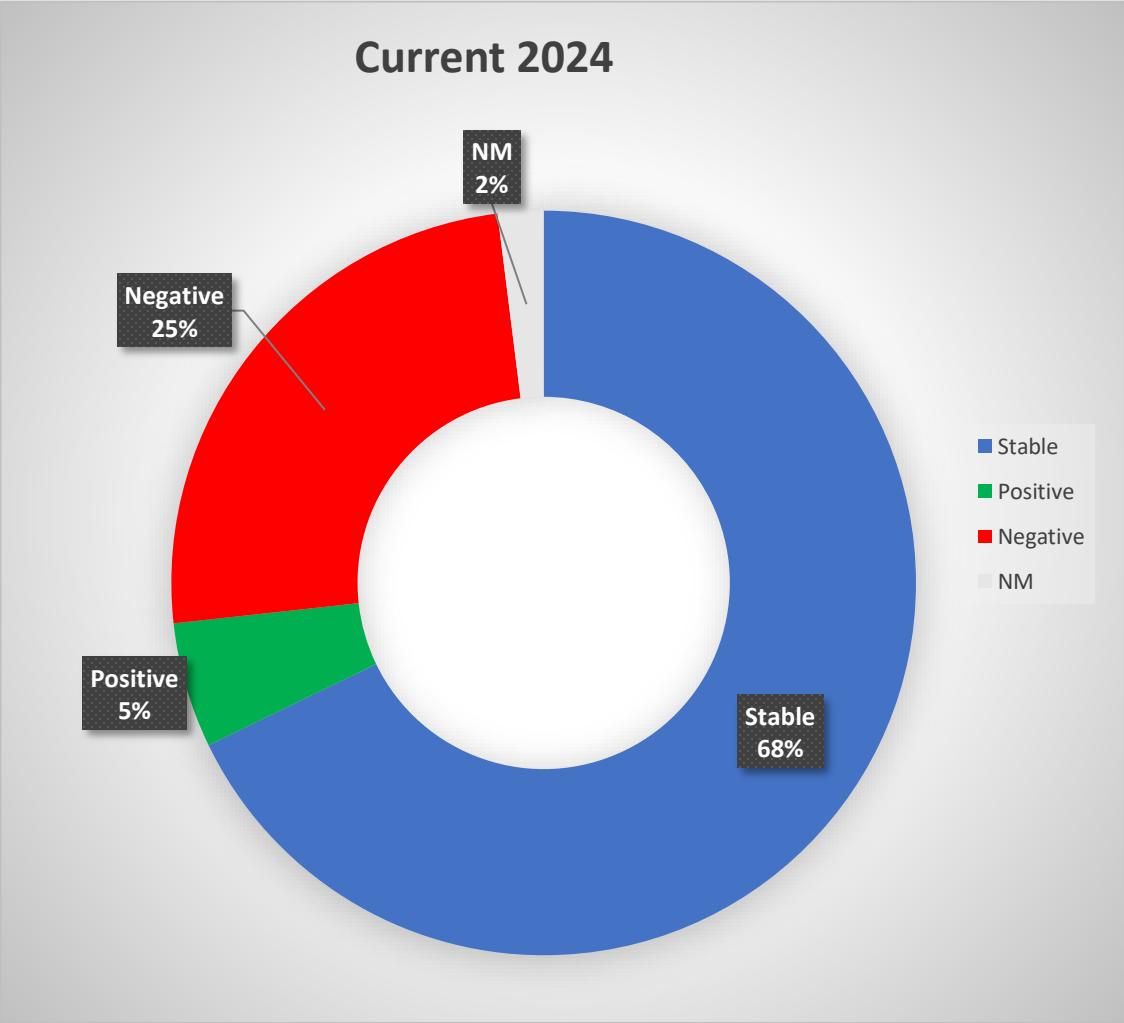
U.S. Healthcare Ratings Distribution - Current



U.S. Healthcare Ratings Distribution – 12/31/2019



U.S. Healthcare | Negative Outlook on One in Every Four Ratings



U.S. Healthcare | Thoughts on the Major Subsectors

Healthcare Services

- Not a demand issue, expect 6-7% topline growth. Improving labor trends, though recruiting/retention/perm, costs still elevated.
- Improvement not robust enough to overcome higher cash interest costs, cash flow impact from No Surprise Act.
- Reimbursement levels have barely kept up with cost increases, continued pressure on efficiency measures.

Pharmaceuticals and Biotech

- Low-to-mid single digit growth, despite headwinds from LOEs, biosimilars, looming impact of IRA.
- Net pricing to be largely flat.
- M&A will be a key driver of ratings, longer term keeping an eye on potential drug pricing related legislation.

Medical Devices and Products

- Strong procedure demand, easing healthcare labor constraints, return of patients.
- Expect organic revenue growth of 5-7% in 2024-2025.
- Margins steadily returning to pre-pandemic and expectations of increased M&A in sector.

U.S. Healthcare | Thoughts on the Major Subsectors

Life Sciences

- Improved performance following challenging 2023, bio-pharm spending to normalize in 2H24.
- China slowdown is temporary as long-term demand remains solid, growth resumes though likely at a lower rate.
- Industry to remain active on the M&A front.

Healthcare Technologies/IT

- Healthcare spending on software and IT services to remain strong in 2024, mid-to-high single digit growth.
- Industry is still characterized by high leverage and limited cash flows.
- Anticipate moderate levels of M&A, limiting ratings upside potential.

Health Insurance

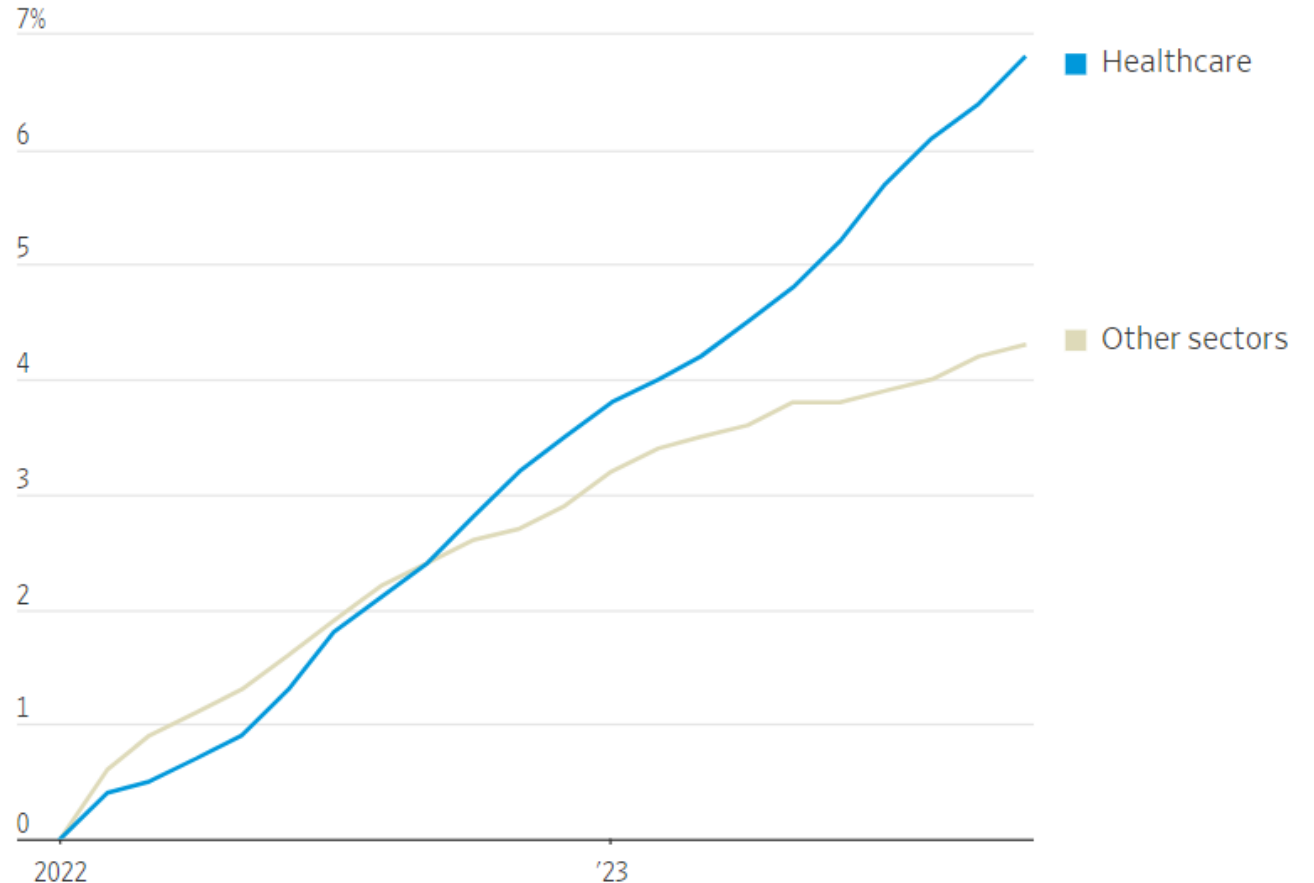
- Revenue growth moderating to mid-to-upper single digit, given some headwinds in MA growth and Medicaid redeterminations.
- Greater earnings pressure, particularly in government segments.
- Legislative risk confined mostly to headline risk.

U.S. Healthcare | Healthcare Labor Remains a Long Term Challenge

Labor situation has improved.

- Companies projecting 4-5% growth in 2024, down from 5% in 2023 and 9% in 2022.
- Improvement is uneven, depending on specialty and geography.
- Nursing improving, contract labor use levels down, but costs to recruit/retain and permanent staff costs are higher.
- Physician shortage will remain a problem for years, due to early retirements, healthcare demand increasing.

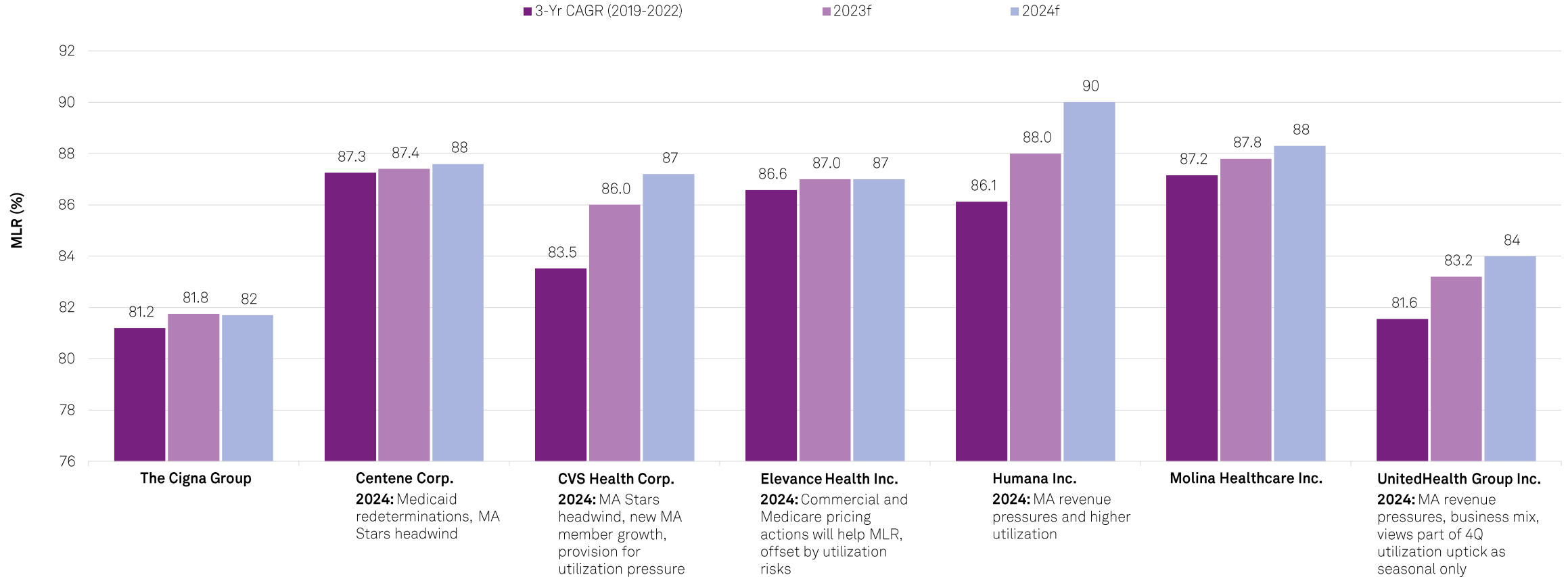
Employment, change from January 2022



Note: Seasonally adjusted
Source: Labor Department

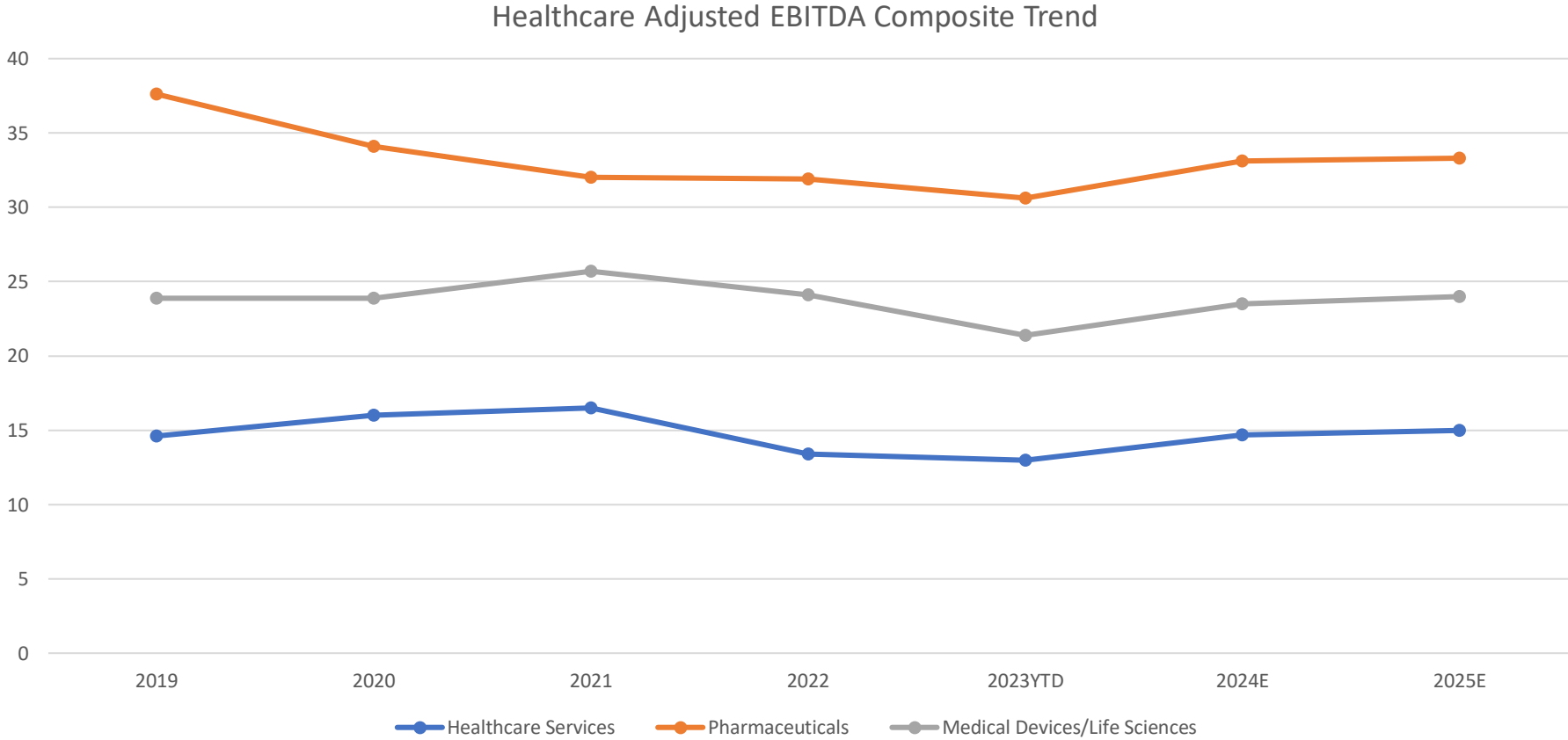
Operating Performance: Medical Loss Ratio By Company

MLR pressure from MA and Medicaid in 2024



Note: 2023 actual used for Elevance Health, Humana, and UnitedHealth. Source: Company filings and presentations, S&P Capital IQ, S&P Global Ratings.

U.S. Healthcare | Adjusted EBITDA Margins Remain Sub-2019



Adjusted EBITDA Margin Expectations	2019	2020	2021	2022	2023YTD	2023E	2024E	2025E
Healthcare Services	14.6%	16.0%	16.5%	13.4%	13.0%	13.7%	14.7%	15.0%
Pharmaceuticals	37.6%	34.1%	32.0%	31.9%	30.6%	30.8%	33.1%	33.3%
Medical Devices/Life Sciences	23.9%	23.9%	25.7%	24.1%	21.4%	22.3%	23.5%	24.0%

U.S. Healthcare | Legislative, Regulatory, And Legal Risks

Divided government likely means incremental health care proposals



Presidential Elections

Health care will be a top issue, tied to the economy, in the 2024 elections. We expect mostly headline risks during the election cycle. Both parties will likely pursue incremental health care proposals compared with past elections, which featured “Repeal & Replace (the ACA)” and “Medicare-for-All.”

One topic that may come up will be the Inflation Reduction Act of 2022’s enhanced ACA subsidies for consumers, which will expire in 2025. ACA opponents may propose to let the subsidies expire or use it as a bargaining chip for extending certain provisions of the Tax Cuts and Jobs Act of 2017 that are expiring in 2025.



Legislative Agenda

We expect limited legislative risk for the sector in 2024. This is based on expected gridlock in a split Congress and the likely pause in substantial legislation in second-half 2024 during the presidential election season.

However, one area with bipartisan support is PBM legislation, which may pass in first-half 2024. Legislation will likely have a manageable impact for PBMs, especially if the focus is on areas such as pricing and business practice transparency (with reporting requirements) and spread pricing in Medicaid.

Moreover, PBMs will have time to renegotiate contracts with clients and manufacturers in reaction to legislation.

Regulatory and Legislative Watch Items

Medicare Advantage (MA) rates for 2025: Rates will be released in February and finalized in April. We expect a rate increase of 0%-2% for 2025 versus a decline of 1.1% for 2024.

No Surprise Act: These affect product competitiveness and profitability. The 2025 Star Ratings (affecting 2026 payments) will be released in Fall 2024.

Medicaid Redeterminations: States started redeterminations in April-July 2023, and will complete this process during H1 2024.

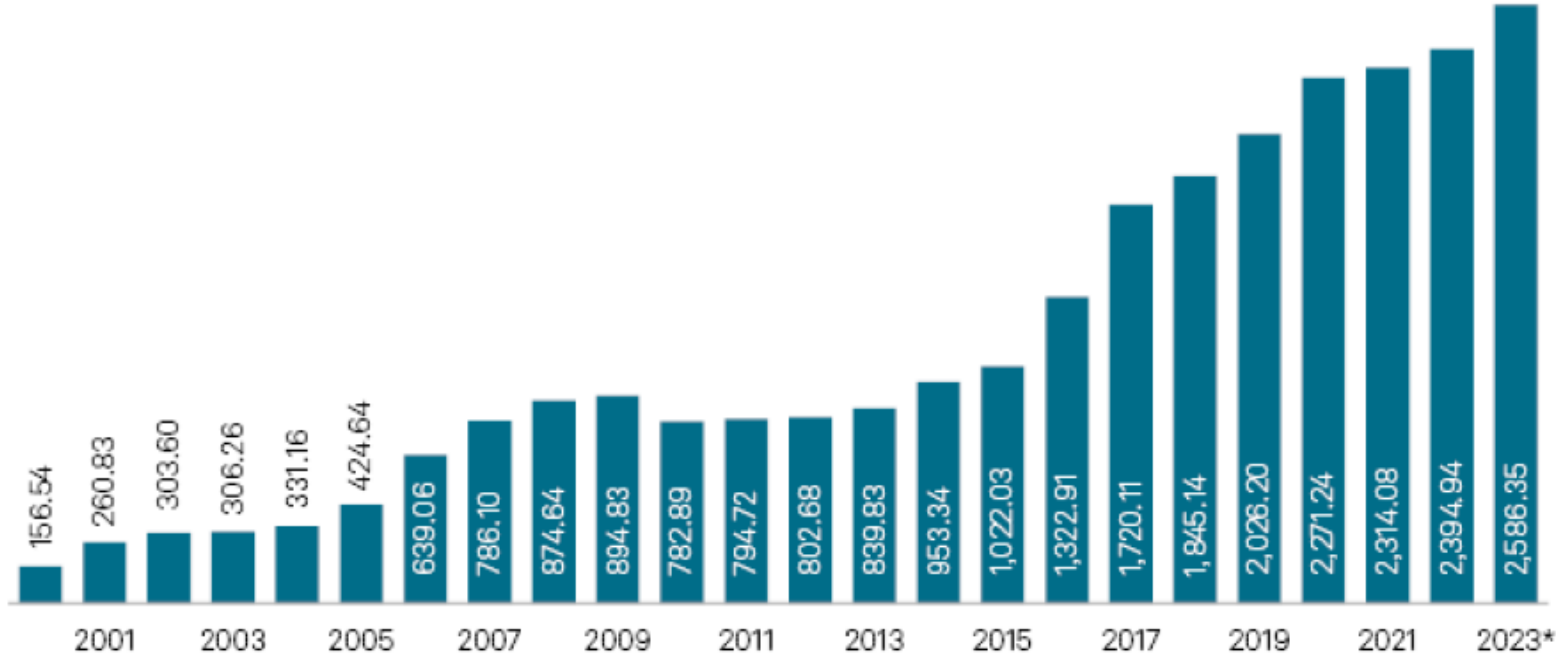
Inflation Reduction Act: Medicare to begin negotiating drug prices in for Medicare Part D in 2026 and Medicare Part B in 2028.

Site Neutrality: Bipartisan support to standardize outpatient care payments could result in significant payment cuts for hospitals.

PBM Scrutiny: The Federal Trade Commission study could be released in 2024 and include proposed regulatory or enforcement actions against PBMs.

U.S. Healthcare | Private Equity Returns to Healthcare Deals?

Global private equity dry powder trend, 2000-2023 (\$B)



Data compiled Dec. 1, 2023.

* Year to date through Dec. 1, 2023.

Analysis includes aggregate dry powder of global private equity funds with vintage year between 2000 and 2023.

Dry powder data is supplemented by Preqin.

Source: S&P Global Market Intelligence.

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U.S. Healthcare | GLP-1s a \$100 billion market by 2030?

A Mega-Blockbuster for Eli Lilly?

- A potential \$8-10 billion a year drug.
- Pharma, med device, and life sciences do have significant capacity within current ratings for M&A.

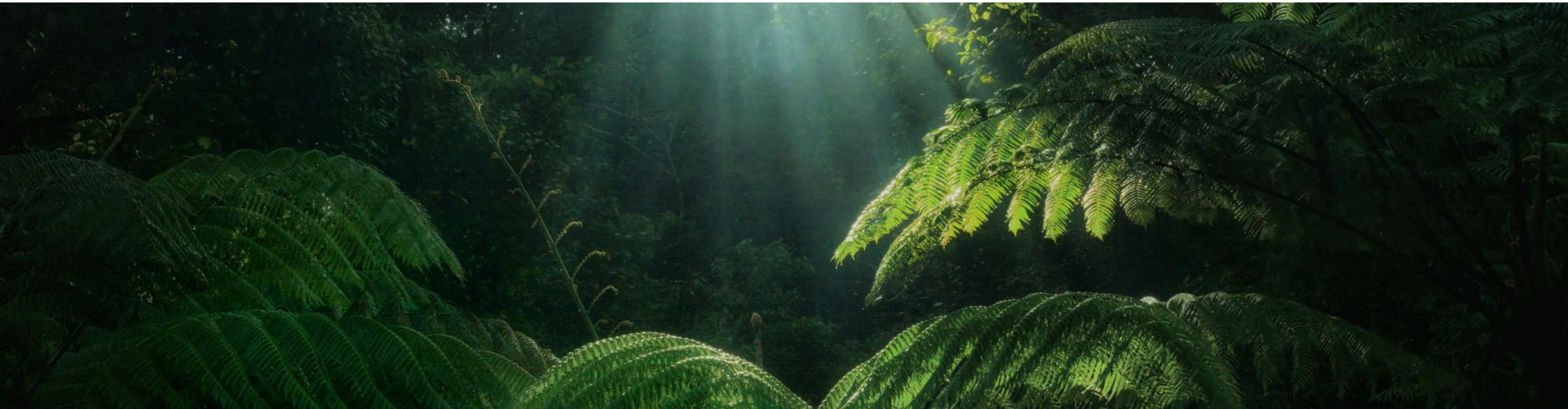
Coverage/reimbursement will be key.

- How health insurers and Medicare will cope with costs.

Collateral impact on procedures and medical device demand.

Q&A

S&P Global Ratings
2024 Outlook Series



Related Research

- Industry Credit Outlook 2024: Healthcare, Jan. 9, 2024
- Pharmaceutical Industry 2024 Credit Outlook is Stable as Revenue Growth Mitigates Pressures, Jan. 24, 2024
- [U.S. Health Insurance Sector View 2024](#), Jan. 31, 2024
- [Economic Outlook U.S. Q1 2024: Cooling Off But Not Breaking](#), Nov. 27, 2023

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