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New Capital Healthcare Disruptors Fund

MAY 2021



What do we mean by Healthcare disruption?

The concept of disruption describes the process whereby a new company is able to successfully challenge established incumbent businesses. The disruption process is characterised by entrants targeting overlooked segments of a market and gaining traction with low-end or new market territories.¹ Over time, some entrant companies gain presence within the market as they serve a growing demand based on price differentiation or new technologies. Disruption in the healthcare sector has potential to affect aspects such as new scientific developments, medical devices, diagnostic tools, digital health platforms, regulation, education and improvements in processes, such as the use of “Big Data” or “Artificial Intelligence”.

Industries that are technologically stagnant tend to have slower growth in real output than the technologically dynamic ones. Historically, overly expensive or underperforming businesses have been subjects to disruption. Therefore, the continued rise in healthcare costs and the lack of competitors in parts of the market make this sector an attractive segment for disruption given potential for technological innovation and productivity gains.

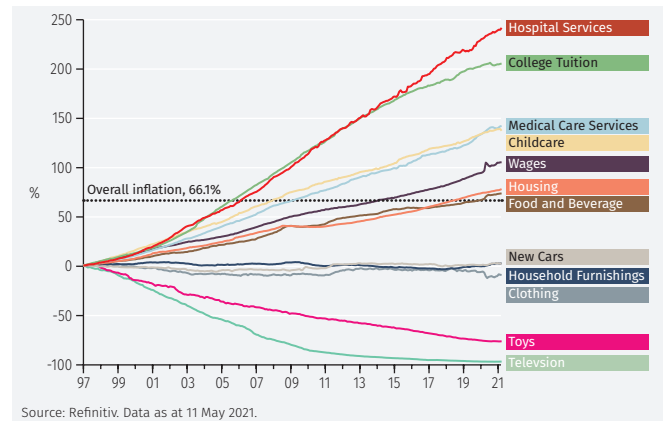
Differences between stagnant and dynamic sectors

In 1967 William Baumol and William Bowen presented an economic model arguing that a technologically stagnant sector would experience above average cost and price increases and would represent a rising share of national output, despite exhibiting slow aggregate productivity growth.

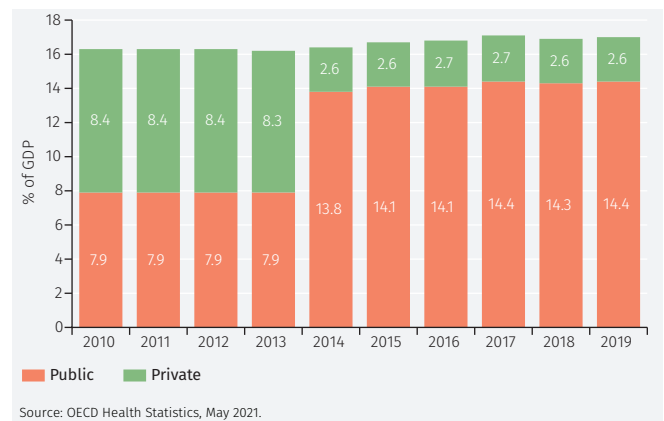
Labelled Baumol’s cost disease, the model stated service-producing sectors, such as education and healthcare, which rely heavily on human interaction have less growth in productivity over time as humans cannot be engineered to perform these same activities in a more efficient way. Alternatively, in goods-producing sectors, such as manufacturing, workers can become more productive as a result of technological innovation that helps save time and costs. As a result, wages and overall spending in the stagnant sector normally increase to prevent workers moving to the more productive sectors, where wages increase as a result of higher productivity.

In the US, the Baumol effect helps explain why healthcare costs have increased considerably more than overall inflation. Between January 1997 and March 2021, the cost of hospital services in the US has increased by close to 250%. Similarly, the cost of medical care services increased by 142%, while overall US consumer prices increased by 66% over the same time period.² Additionally, US healthcare spending has grown consecutively for the last four years, with particular growth in public expenditure following the introduction of the Affordable Care Act. Healthcare spending currently represents around 17% of the country’s GDP. Despite this, life expectancy in the US has plateaued at 78 years, not reflecting an improvement in line with spending growth.³

1. Year-on-year price changes for selected US sectors



2. US Public and Private health expenditure



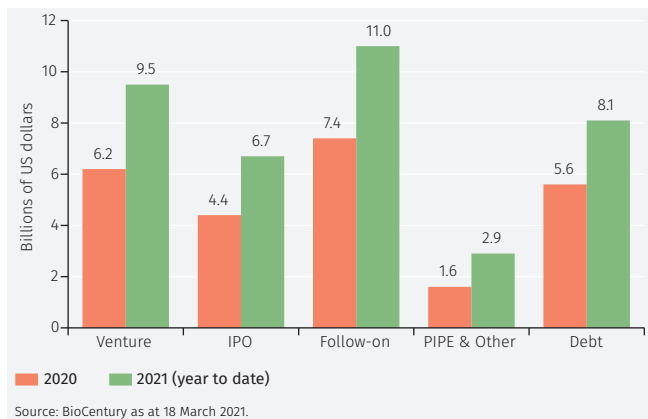
¹ Sounderajah V, Patel V, Varatharajan L, et al, ‘Are disruptive innovations recognised in the healthcare literature? A systematic review’, *BMJ Innovations* 2021;7:208-216.
² US Bureau of Labor Statistics.
³ Centers for Medicare & Medicaid Services. <http://www.cms.gov>

The time for disruption in Healthcare

A recent joint study by the World Bank, the Bureau of Economic Analysis and the US Department of Treasury found that innovation commonly led to quality-adjusted price declines in the US medical sector.⁴ An example of the deflationary characteristics of technological innovation has been the decline in price of corrective eye surgery costs in the US. The recent implementation of automated and more efficient laser technologies for eye surgery allowed for a significant reduction in prices to USD 3,000 from USD 20,000 almost 20 years ago.

We believe that similar opportunities exist in many areas such as new treatments, techniques, vaccines, automation of medical devices and the surge in digital platforms and connected devices such as watches and wrist bands which could all contribute to the continued growth in the sector.

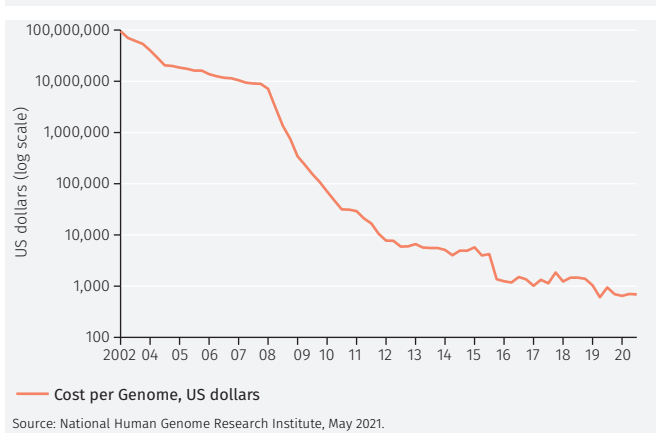
3. US biotech fundraising



Genomics

One of the areas facing the biggest degree of disruption is genomics. Whole-genome sequencing is a comprehensive method to analyse entire genomes, which has been instrumental in identifying inherited disorders and tracking disease outbreaks. In the early 2000s the cost of sequencing a human genome was around \$100m but today it is less than \$1,000, far outpacing the productivity gains Moore's Law would have estimated. While the speed of the drop in sequencing costs is impressive there is still further room to lower these costs and raise the quality of sequencing.

4. Cost per Genome



This has opened the door to a \$10bn molecular diagnostics market that can help detect new cancers and relapses before the patient is symptomatic. Identifying cancers early is the most effective way to reduce cost and of course save lives. Oncologists also have greater understanding of the genetic mutations that cause cancer. Often patients are given expensive therapies which yield little results so being able to offer more targeted therapies can boost the cost efficiency.

Improvements in genome sequencing is not just limited to humans but can in fact be scaled over to animals and agriculture. The pandemic has underscored the need for improvements in livestock health and food safety. In the case of pets, the pandemic has brought about increased pet ownership as well as a greater emphasis on taking care of their health.

New therapeutic platforms

Over the last 25 years or more, the focus for the pharmaceutical industry was to create wonder drugs, such as statins, which were patent protected that then led to out-sized profits whilst the patent was in force. Once patents expired and such blockbuster drugs became generic, the industry's focus moved on to biologics. With the utility of biologics now being exhausted, the industry has shifted its attention to new therapeutic platforms, such as gene therapy, immunotherapy and RNA technology.

⁴ Dauda S, Dunn A, Hall A., 'Are Medical Care Prices Still Declining? A Systematic Examination of Quality-Adjusted Price Index Alternatives for Medical Care', Hutchins Center Working Paper 59. March 2020.

Gene therapy focuses on the genetic modification of cells to treat or cure a disease. This can be done by replacing a mutated gene with a healthy copy or inactivating a mutated gene that is not functioning properly. Gene therapy is still largely experimental and whilst the single cost of such procedures is high, this compares very favourably to the hundreds of thousands of dollars a patient spends in hospital over a lifetime. Immunotherapy is a type of biological therapy aimed at harnessing the body's immune system to fight infections and diseases, with particular use in cancer treatment. In many cases immunotherapy is more effective in driving cancer cures, as compared to toxic chemotherapeutic regimens.

Messenger RNA has gained prominence for its use in Covid-19 vaccines. This involves creating artificial strands of RNA containing genetic code, injecting it into the patient to trick the body into producing some of the spike proteins of the virus and allowing the immune system to build up its defence to Covid-19. Even pre-Covid, Messenger RNA had been on the radar as a great potential cure for cancer and other diseases. Additionally, the next generation of antibodies can now hit multiple druggable targets and even carry chemotherapeutic payloads that act as "smart bombs" in the fight against cancer.

Advances in medical devices

Hospitals are great breeding grounds for bacteria and so there is a need to get patients in and out as fast as possible to reduce the chance of picking up an infection. This has led to a greater emphasis on minimally invasive procedures. Taking for example a patient with a faulty heart valve, a minimally invasive procedure could see them leaving hospital in a matter of days compared to weeks if they had undergone open heart surgery. Besides the benefit of a shorter hospital stay, the efficacy is the same, if not better.

In an age of data consumption and increased emphasis on health, wearable technology has come of use and is now readily available. Advances in miniaturization have created a new industry of implantable or wearable technologies that can proactively treat or monitor patients for a variety of conditions. One example is a company offering a continuous glucose monitor. Rather than a finger-prick, a small device

is worn which is compatible with smartphones and watches allowing the wearer to monitor blood glucose levels 24/7. This gives diabetics an indication of where their blood glucose levels are heading so they can administer medication accordingly. The sensor is available for use by both adults and children, allowing parents of children with Type 1 diabetes to monitor their child's levels while at school.

Healthcare delivery

Healthcare has a reputation for being slow to adopt technology. Technology has been a disruptive force in other sectors, but healthcare offers its own unique parameters and challenges which have limited the pace of adoption. Nevertheless, there are certainly exciting innovations set to improve patient wellbeing and benefit general practitioners and healthcare specialists. Cloud based solutions provide an option to replace the legacy systems of maintaining clinical paperwork which proved expensive. Companies which started out offering a simplistic initial product of cloud-based management systems are now seen as layering more products to their offering. An example is the overhaul of CRM practices, allowing pharmaceutical representatives to reach out to a physician virtually. This has of course been especially important during the pandemic, bringing an alternative to more standard video conferencing platforms which can meet all the necessary compliance guidelines.

Healthcare expenditure accounts for nearly 10% of global GDP⁵ and the pandemic has underscored just how important the sector is. Over the past decades healthcare productivity has lagged other sectors with cost inefficiencies leaving it ripe for disruption. There is now a greater number of companies in this sector offering exciting innovations and new technologies set to displace Large Cap legacy participants facing patent expirations and product obsolescence. These new technologies offer tremendous upside for the three key constituents of healthcare – patients, physicians and payers. For patients, disruptive innovation can not only improve healthcare outcomes, but also offer greater convenience and fewer side effects. For doctors, the technology can streamline workflow and drive an economic incentive for physician practices. And for reimbursement authorities or healthcare payers, innovation can drive down the overall cost of patient care.

⁵ World Health Organisation, Global Health Expenditure Database

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