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Brazil's Promising Diagnostic Lab Market

By Patricia Gonzalez, Analyst

VanEck's Emerging Markets Equity strategy seeks to identify persistent long-term structural growth opportunities. Structural growth can be stock-specific or thematic, and can be driven by a sustainable advantage, which is often company management. Through this bottom-up process, we have identified Fleury S.A. as a potential opportunity, and a prime representative of Brazil's diagnostic lab market as described below (as of May 31, 2017, Fleury represented 1.17% of VanEck Emerging Markets Fund's net assets). This is not a recommendation to buy or to sell any security; Fund securities and holdings may vary.

The diagnostic lab market in Brazil is growing. The sector's expansion will benefit from both aging demographic trends and the country's potential economic recovery. We believe that continued consolidation in Brazil's fragmented healthcare industry is likely to create opportunities for the largest players.

Brazilian Healthcare Industry Expands via Mandated Access

The healthcare industry in Brazil has grown significantly in the past few decades. Underpinning this growth has been the Brazilian Constitution of 1988, which mandates that the state offers the entire population universal and free access to healthcare services through the country's public Unified Healthcare System (SUS).

However, since the SUS has been unable to reach Brazil's entire population of 192 million, private health plans have become increasingly popular. According to the Agência Nacional de Saúde Suplementar (ANS), a national regulatory agency linked to the Brazil's Ministry of Health, 41.9 million Brazilians had subscribed to private health plans by September 2009 (22% of the population at the time), and today that level has reached 25%.

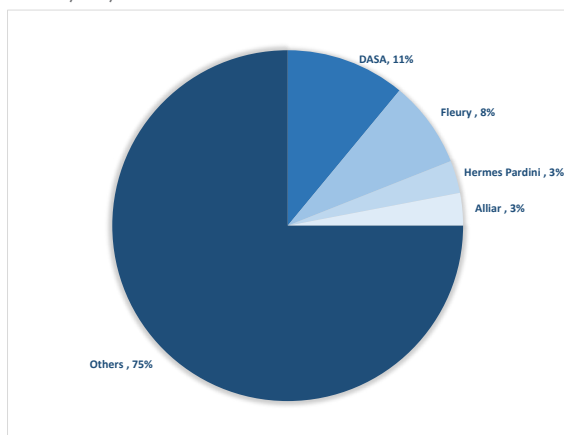
In 2008, healthcare expenditure in Brazil amounted to BRL 249B, with 43% representing public expenditure and 57% private expenditure. In the early 2000s, the three primary drivers stimulating growth in the healthcare sector were income growth, formal employment, and an aging population. Between 2002 and 2008, the Brazilian economy saw real income and formal employment grow at compound annual growth rates (CAGR) of 4.0% and 5.3%, respectively.

In 2015, however, the Brazilian economy deteriorated, slowing growth in the labor market. This negatively impacted the growth of health plans as Brazilians simply had less disposable income to pay for health services. Although industry conditions have been difficult in recent years, both the current prospects for an economic recovery in Brazil in 2017-2018 and the aging demographic data remain positive.

Attractive and Resilient Growth in the Brazilian Diagnostic Lab Market

The Brazilian diagnostic lab market has grown significantly since 2000 and has proven to be resilient, even through the country's recent economic weakness. Private expenditure increased from BRL 20B in 2014 to BRL 25B in 2015, despite a GDP drop of 3.3% over the same period. While the consolidation process among the country's clinical laboratories started in 2000 and has intensified over the last few years, the market continues to be fragmented with more than 22,000 labs spread across Brazil. Currently, the top four market participants — Diagnósticos da América S.A. (DASA), Fleury S.A., Centro de Imagem Diagnósticos S.A. (Alliar), and Instituto Hermes Pardini S.A. (Hermes Pardini) — account for only 25% of private sector revenues. We believe there are strong opportunities for the largest players to continue to consolidate and to increase their market share.

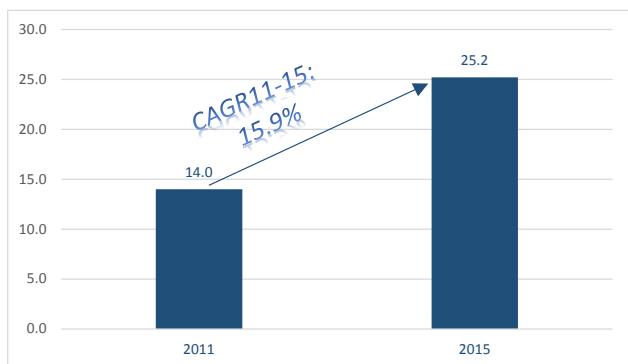
Market Share of Brazil's Top Diagnostic Companies As of 3/31/2017



Source: BofA Merrill Lynch Global Research and companies. Not intended to be a forecast of future events, a guarantee of future results or investment advice. Current market conditions may not continue. Data as of March 2017.

According to Banco Bradesco, in 2015 the Brazilian diagnostics services market reached BRL 48B (approximately US\$14.5B) in size, or approximately 0.8% of GDP, and represents approximately 10.5% of the country's total healthcare spending. Within this market, the insurance-paid segment is the fastest growing. Estimates are that the insurance-paid segment grew at a CAGR of 15.9% between 2011 and 2015, to reach BRL 25B in 2015. Estimated growth for this segment is expected to be approximately 7% -10% annually over the next 10 years. According to ANS, diagnostics represented approximately 21.2% of total insurance spending in 2015. The diagnostic and insurance markets are closely linked and affect each other's growth prospects, which are expected to be healthy over the next few years.

The Growth of Brazil's Insurance Paid Market (BRL B) 2011-2015

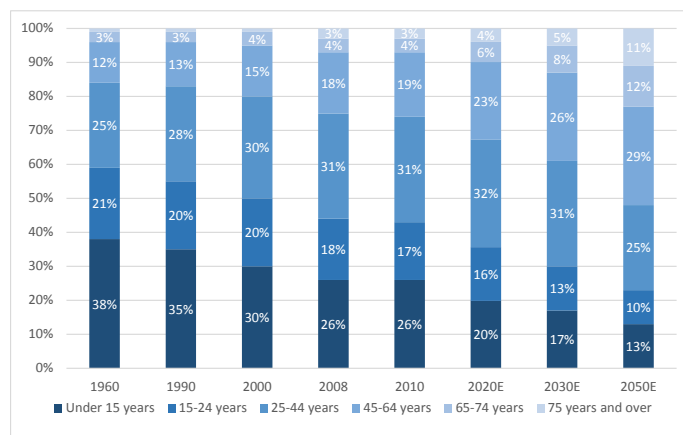


Source: Bradesco BBI and companies. Not intended to be a forecast of future events, a guarantee of future results or investment advice. Current market conditions may not continue. Data as of December 2015.

Long-Term Sector Growth Drivers

One of the main drivers of growth for the diagnostic lab market will continue to be Brazil's aging population. The country's population is set to face a significant demographic shift as those aged 45 and older are predicted to represent 52% of the total by 2050, versus 33% in 2020.

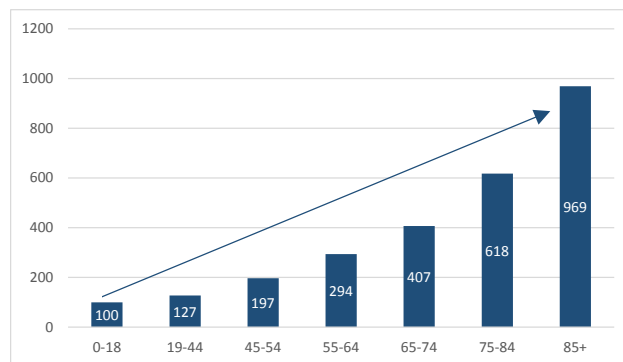
Brazil's Aging Population 1960 – 2050e



Source: Itau BBA and companies. Not intended to be a forecast of future events, a guarantee of future results or investment advice. Current market conditions may not continue. Data as of 2017.

This elderly demographic is expected not only to consume commensurately more healthcare services, including diagnostics, but also to help underpin sustainable growth for at least the next two decades.

The Elderly Spend as Much as 9 Times More on Healthcare than the Young (100 basis)



Source: BofA Merrill Lynch Global Research, IBGE, and ANS. Not intended to be a forecast of future events, a guarantee of future results or investment advice. Current market conditions may not continue. Data as of April 2017.

The increase in the level of penetration of private insurance will also continue to be an important driver. From 2006 to 2016, the penetration of private insurance throughout Brazil's total population increased from 19.9% to 23.2%. The implication is that, with more individuals insured, the use of diagnostic services also increases. While the economic recession in 2015 caused a slight decline in the number of insured people, the numbers are expected to rise again in 2017-2018 after the economy improves.

The adoption of new technology will also stimulate the diagnostic market. In healthcare, innovations do not simply replace existing treatments, but rather enhance the selection of products and services available to consumers. Finally, recent regulation, such as ANS' call for higher levels of service for health insurance companies, may also boost the demand for quality service.

Positive Diagnostic Lab Industry Dynamics

We believe the dynamics of the diagnostic lab industry in Brazil are very positive. The diagnostic market is a growing segment of Brazil's healthcare industry, with demographic trends favoring sector growth in the future. The fragmented nature of the industry also creates big opportunities for the largest players to continue to consolidate. We believe that the country's economic recovery and an increase in disposable income will lead to heightened awareness and better education about healthcare issues. This may result in higher demand for diagnostic lab services. These factors, together with the fact that the diagnostic testing market in Brazil is still developing, should allow for clear growth, and exciting investment opportunities ahead.

Important Disclosures

Any mention of an individual security is not a recommendation to buy or to sell the security. Fund securities and holdings may vary. As of May 31, 2017, Fleury S.A. represented 1.17% of VanEck Emerging Markets Fund's net assets. A current list of the Fund's holdings can be found at www.vaneck.com/gbfax/

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