HBM Healthcare Investments

Healthcare specialist with public/private approach

Investment companies

HBM Healthcare Investments (HBMN) is a Swiss investment company that invests in healthcare companies globally. Its portfolio is spread across private companies, private equity funds and public holdings, many of which began in the private portfolio. After a buoyant IPO cycle it currently has a relatively low proportion invested in private companies (14% at 31 December versus an average since inception in 2001 of 35.6%), but this is set to rise, with $17.5m already committed to two new private investments so far in 2016. HBMN invests broadly across healthcare (diversified by sector, geography and company size) rather than concentrating on the recently more volatile area of biotechnology. It has outperformed the MSCI World Health Care Index over one and three years. Each year 5-8% of NAV is expected to be returned to shareholders through a combination of share buybacks and capital distributions (current yield of 5.6%).

12 months ending	Share price (%)	NAV (%)	MSCI World Health Care (%)	NASDAQ Biotech (%)	FTSE All-Share (%)
31/01/12	(5.2)	(8.8)	9.6	21.5	(3.9)
31/01/13	19.3	5.9	22.8	25.1	15.7
31/01/14	58.5	74.2	28.0	68.5	13.5
31/01/15	34.5	23.4	22.6	33.4	(0.6)
31/01/16	8.1	7.3	7.4	(7.2)	0.3

Note: Total returns, in CHF terms.

Investment strategy: Long-term, patient investor

HBMN's manager, HBM Partners, is a specialist healthcare investment manager with teams focusing on direct public and private equity investments, and established relationships with private equity fund managers around the world. Team members have a range of clinical and business specialisms and the sharing of information ensures both teams have the fullest picture of competitive opportunities and threats. The investment approach is long-term, with private holdings often retained after IPO, and some stocks having been in the portfolio since the fund's inception in 2001.

Market outlook: Sell-off may present an opportunity

Rising investor risk aversion in early 2016 has seen a sharp sell-off in global equity markets, with global biotech and healthcare indices falling 15% and 9% year-to-date. While further volatility is likely in the near term, favourable fundamentals for healthcare companies, including demographic trends, scientific innovation and a largely supportive regulatory backdrop, mean weakness in share prices and a slower pace of IPOs could provide opportunities for public and private equity investors alike.

Valuation: Discount close to long-term averages

HBMN's discount to net asset value averages c 25% over one, three and five years. The discount stood at 27.4% at 25 February. Strong recent performance for HBMN could lead to increased demand for the shares, and the company is active in buying back shares to manage discount volatility. A conservative approach to valuing private equity holdings means there is also potential for NAV uplift, as seen with the recent trade sale of Ellipse Technologies.

26 February 2016

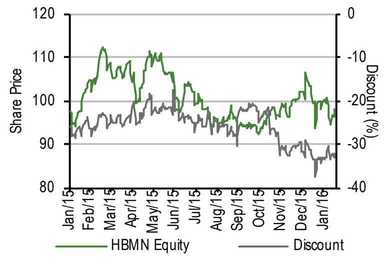
Price	**CHF97.45**
Market cap	**CHF750.4m**
AUM	**CHF1,032.9m**

NAV*	CHF134.1
Discount to NAV	27.4%

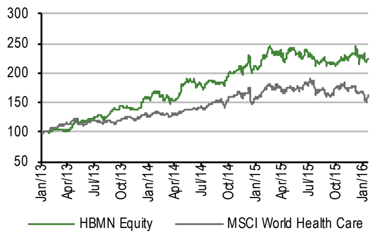
*Including income. Data at 25 February 2016 (NAV at 15 February).

Yield	5.6%
Ordinary shares in issue	7.4m
Code	HBMN
Primary exchange	SIX
AIC sector	N/A

Share price/discount performance



Three-year cumulative perf. graph



52-week high/low	CHF112.5	CHF92.0
NAV** high/low	CHF149.8	CHF119.3

**Including income.

Gearing

Gross*	10.1%
Net*	4.9%

*As at 31 December 2015.

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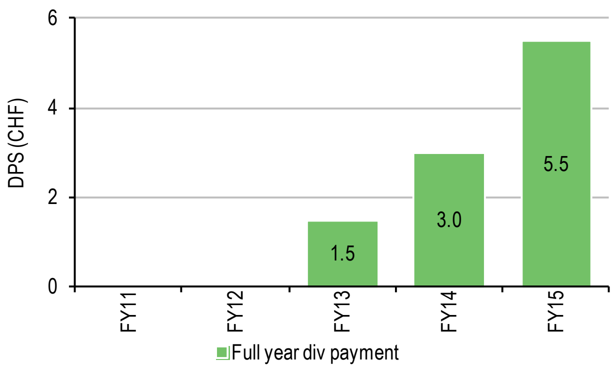
HBM Healthcare Investments is a research client of Edison Investment Research Limited

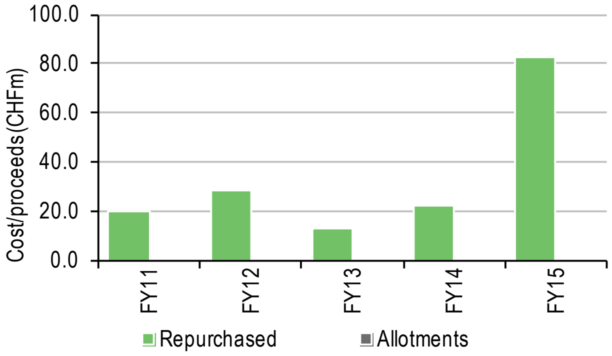
Exhibit 1: Fund at a glance

Investment objective and fund background	Recent developments
HBM Healthcare Investments (previously HBM BioVentures, renamed in 2012) aims to generate long-term gains through investment in private and public companies in the human medicine, biotech, medtech and diagnostics sectors, and related areas. It invests worldwide, predominantly in private companies, either directly or through funds, and many of its publicly listed holdings began as private equity investments.	■ 12 January 2016: HBM Healthcare Investments announces $7.5m contribution in $40m financing round for Iconic Therapeutics, a private company specialising in eye diseases. ■ 6 January 2016: Sale of privately held Ellipse Technologies, of which HBM owns c 32%, to NuVasive for $380m. ■ 4 January 2016: HBM NAV +23.6% in fourth quarter 2015, share price +10.9%.

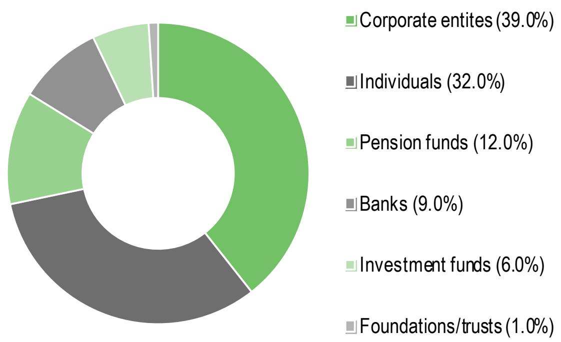
Forthcoming		Capital structure		Fund details	
AGM	June 2016	Ongoing charges	1.5% (see page 11)	Group	HBM Partners
Annual results	May 2016	Gearing	4.9%	Managers	Team-managed
Year end	31 March	Annual mgmt fee	0.75% of NAV + 0.75% of market capitalisation	Address	Bundesplatz 1, 6300 Zug, Switzerland
Dividend paid	End June/early July	Performance fee	Yes – see page 10		
Launch date	July 2001 (listed since February 2008)	Fund life	Indefinite	Phone	+41 41 710 75 77
Continuation vote	No	Loan facilities	CHF100m bond issue	Website	www.hbmhealthcare.com

Dividend policy and history	Share buyback policy and history
From FY13 HBMN adopted a policy focused on shareholder value, whereby c 3-5% is returned to shareholders annually as a capital distribution, subject to portfolio performance and liquidity.	HBMN buys back shares in the market to help manage its discount. Its current buyback authority was granted in 2014. The FY15 figure includes an issue of put options, which saw an additional 564,897 shares repurchased.

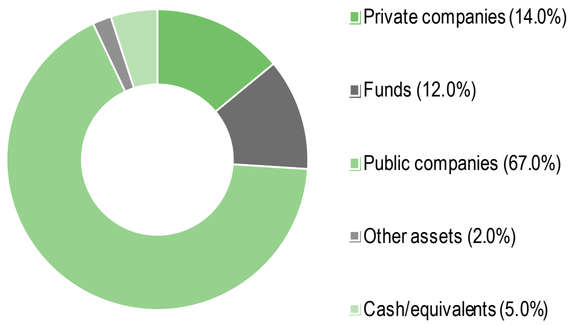




Shareholder base (as at 31 December 2015)



Portfolio exposure by status (as at 31 December 2015)



Top 10 holdings (as at 31 December 2015)

			Portfolio weight %	
Company	**Country of listing**	**Clinical focus**	**31 December 2015**	**31 December 2014**
Skyepharma	UK	Drug delivery (respiratory)	15.3	13.5
Advanced Accelerator Applications**	France	Imaging and radiotherapy	9.6	3.1
Pacira Pharmaceuticals**	US	Pain management	7.4	9.9
Ophthotech**	US	Ophthalmology	4.1	5.0
Cathay Industrial Biotech*	China	Industrial polymers	3.9	1.4
Incyte	US	Oncology	3.5	0.9
Genmab	Denmark	Oncology	3.4	1.7
Ellipse Technologies*	US	Medical devices (orthopaedic)	3.0	1.8
Paratek Pharmaceuticals**	US	Anti-infectives	2.7	6.9
Nabriva Therapeutics**	US	Anti-infectives	2.5	1.1
Top 10			**55.5**	**45.2**

Source: HBM Healthcare Investments, Edison Investment Research, Morningstar, Thomson Datastream. Note: *Private company. **Public company that has been held since before IPO.

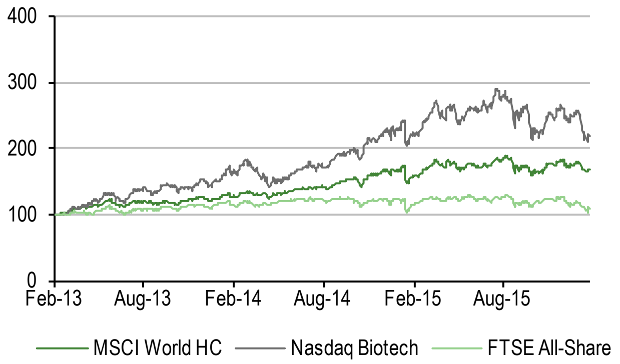
Market outlook: Opportunities amid global sell-off

Public equity markets have begun 2016 in volatile mood, with only six equity indices out of a global list of 114 monitored by Morningstar posting positive year-to-date total returns in local currency at 15 February. Biotechnology, one of the star performers of the past three years, has witnessed one of the sharpest reversals, down 15.0% in the first six weeks of the year. (The broader MSCI World Health Care Index has fallen less precipitously, but is still down c 9%).

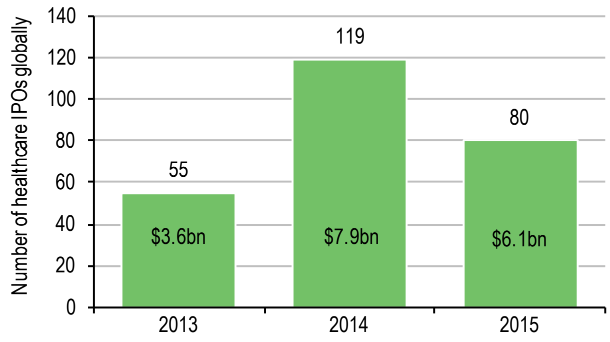
A lack of major clinical disappointments in healthcare and biotech suggests the downward moves are largely a result of investor risk-aversion, meaning that this could prove a favourable entry point for long-term investors, although further volatility is likely in the immediate future. Valuations also look more favourable than hitherto, with estimated 2016 forward P/E ratios of 13.6x for large US pharmaceutical firms and 15.7x for those in the EU, largely in line with the 14.9x forecast for the MSCI World Index (in recent years pharma and biotech have tended to trade at a premium).

Exhibit 2: Global healthcare trends

MSCI World Health Care, NASDAQ Biotech and FTSE All-Share (CHF)



Healthcare IPOs on major Western exchanges by number and value (US$)



Source: Thomson Datastream, EvaluatePharma, Edison Investment Research. Note: IPOs exclude spin-outs from listed companies.

Decreasing risk appetite could lead to a slowing in healthcare IPOs, of which there were 80 on major Western stock exchanges in 2015, down from 119 in 2014 (Exhibit 2, right-hand chart). The fundamentals underlying growth in the healthcare industry remain intact: demographic trends including ageing populations and increasing demand from emerging markets, a supportive regulatory environment, and a fast pace of innovation underpinned by greater understanding of disease processes and human biology. A fund investing both in public companies (where prices may look more attractive following the sell-off) and those at an earlier stage of development that are yet to come to market – with the flexibility to move between the two – may thus be well placed to capitalise on such developments.

Fund profile: Diversified fund with a private equity core

HBM Healthcare Investments (HBMN) is a specialist closed-end investment company that seeks capital growth by investing in companies across the healthcare and biotechnology sectors. Formed in 2001, it was listed on the Swiss SIX Exchange in 2008 as HBM BioVentures, changing its name to HBM Healthcare Investments in 2012 to reflect its broader focus on public as well as private companies, and growth as well as venture capital. HBMN invests in private companies, both directly and through a portfolio of funds, and in publicly quoted companies. At 31 December 2015 some 43% of the public holdings by value (c 31% of the total investments) had begun as private holdings. The portfolio is global in nature, with a US weighting of c 68% at 31 December in line with that of the reference index, MSCI World Health Care. It is broadly spread by clinical focus, and currently more than half the portfolio is invested in companies that are either profitable or generating revenues from marketed products. This is high in historical context and could change over time as proceeds from recent exits are invested in new private holdings at an earlier stage of development.

HBMN is managed by HBM Partners, based in Zug, Switzerland. The management team is led by Dr Andreas Wicki (CEO) and Erwin Troxler (chief financial officer), and includes specialists in both public and private investments. In 2012 HBMN adopted measures aimed at providing a yield and limiting discount volatility, under which it returns 5-8% of capital to investors each year through a combination of capital distributions and share buybacks. Based on the most recent distribution, the fund currently yields more than 5%.

The fund manager: HBM Partners

The managers' view: Finding opportunities wherever they arise

HBMN's managers see the fund's closed-end structure and its public/private split as key advantages. The availability of permanent capital means the fund can invest in later-stage private companies and can add to investments at IPO and, if a public company experiences difficult times that might see less specialised investors withdrawing support, it can add to investments on weakness. Chief Financial Officer Erwin Troxler notes that the managers' job is to seek to make money for investors regardless of the market environment, so the ability to put money into public companies at any time is a key differentiating factor compared with pure private equity investors.

Holding public companies also gives the managers flexibility regarding the financing and timing of investments. Currently a relatively low proportion of assets is invested in earlier-stage companies that may have higher funding needs (1% each in pre-clinical and Phase I and 9% in Phase II), but where such needs arise, cash can always be raised from the sale of public holdings. Following the recent exit from public company Basilea Pharmaceutica and the trade sale of private holding Ellipse Technologies (see Recent investments and exits section for details), the fund has a relatively high cash balance (estimated at 13% in mid-February), which it is putting to work in new opportunities such as Iconic Therapeutics and ARMO BioSciences.

While the current allocation to private companies looks low in historical context, CEO Andreas Wicki is keen to stress that the fund is still very much focused on private equity or private equity-style investment. "Almost anything capable of an IPO in the last four years has been floated, so our private equity portfolio has been depleted," he says. However, the managers are open to co-operation with other like-minded investors, as illustrated by the two new deals, where it has invested alongside the likes of Google Ventures, biotech giant Celgene, and specialist healthcare investment manager OrbiMed.

The two recent investments in 2016 add extra exposure in the areas of oncology (ARMO operates in the fast-developing area of cancer immunotherapy) and ophthalmology (Iconic is developing novel approaches to retinal disease). Another example of an area of interest is hyperkalaemia (a condition caused by excessive levels of potassium in the body). Wicki notes that this area had been hard to get into on the private equity side, as major players ZS Pharma and Relypsa were both inaccessible when private. HBMN bought stakes in both companies at IPO and increased its holding in Relypsa when ZS Pharma was acquired by AstraZeneca (at a 42% premium) in late 2015.

Skyepharma: A public holding with a private approach

HBMN's portfolio is broadly diversified by geography, investment type, development stage and clinical focus, but at the top of the stock list is a very large (c 15% of total assets) position in Skyepharma. The British company (with a laboratory in Switzerland) is involved in the development of oral and inhalation drug delivery; its main asset is the asthma inhaler Flutiform, which delivers a combination dose of a corticosteroid (preventer) and a long-acting beta-2 agonist (reliever).

HBMN has been an investor in Skyepharma since 2001 and has taken a private equity-style approach, owning a significant proportion of the company (28.5% at 31 December 2015). It remained close to the business through a difficult period in 2008/09 when Flutiform failed to gain US approval, and was involved in a capital raising in 2014 that saw the company's debt reduced substantially. Wicki says the HBMN team took the view that the business could be restructured and become profitable – a conviction that has been vindicated by the company's recent results and a rising share price (up 464% over three years to 15 February, although it has fallen back slightly in market volatility since the start of the year).

Wicki sees Skyepharma as a low-risk, stable investment – with products already successfully on the market, it does not have the binary risk characteristics of earlier-stage companies – and a potential source of cash in the future. He points out that the company has net cash and is generating substantial income from royalties (including from Pacira, spun out of the company in 2007), and has many options (including potential acquisitions of new technology) because it is now solidly financed.

Asset allocation

Investment process: Private equity approach at its core

HBMN invests across public and private companies, but sees its private equity focus as the main investment driver. Almost half of the public portfolio by value began as private holdings, and even among those that were bought as public companies, the majority have similarities with private equity investments, characterised by holding a large stake and having significant input into governance and strategy. The fund's investment universe ranges across several areas of healthcare – biopharmaceuticals, generic drugs, diagnostics and medical devices. It is less focused on healthcare services and providers, medical equipment and tools and services. The managers prefer to invest earlier in the clinical cycle than some more generalist investors, recognising that much of the upside in value can come at the pre-Phase III stage.

HBM Partners' team of 18 investment professionals is split into public and private teams, although there is significant collaboration between the teams. Many of the managers have professional or research backgrounds in healthcare, and have expertise across a range of clinical indications. Weekly investment meetings involve both teams, allowing them to share information on competitive opportunities and threats, and the latest clinical developments. CEO Andreas Wicki explains that the public managers' experience of market cycles allows them to take a more dispassionate view, and when a private company becomes public, responsibility passes to the public team. Both teams make use of their global industry networks and may draw on the expertise of external business advisers.

Some of the private equity investment is undertaken via funds (12% of the portfolio at 31 December). This allows the fund to gain exposure and to select opportunities in geographies such as China. The funds allocation dates back to HBMN's inception and began as a way of accessing the US market, with the team making investments in leading funds on the East and West coasts with different strategies. As HBM Partners has grown, it has built its in-house expertise in the US and European markets, but retains the exposure to funds in order to access two specific areas of opportunity: 'company builders' like the MedFocus II fund, and those such as HBM Genomics, which work with leading research universities to invest small amounts in promising start-ups.

One area the managers favour is platforms – where a company has clinical assets or technology that can be applied across a range of indications or licensed out to other companies.

Catalysts for reappraisal of investments may include scientific innovations, or delivering clinical proof of principle. HBMN's managers use the example of Advanced Accelerator Applications, where they invested at Phase II in 2014. The company published positive Phase III data in September

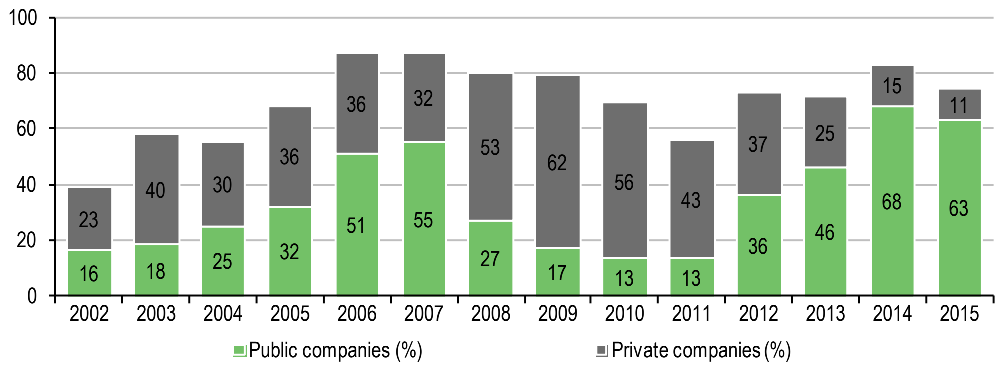
2015 and this facilitated its flotation on the NASDAQ exchange in November, resulting in a significant rise in the value of HBMN's holding (see Performance, below).

Private equity holdings: Evolution and valuation

While HBMN sees itself as primarily a private equity or private equity-style investor, the proportion of the portfolio held directly in private companies has fluctuated significantly over time (Exhibit 3). This is largely as a result of market cycles. When publicly quoted healthcare stocks are in high demand, there is greater appetite for initial public offerings of private companies, so the proportion of the portfolio in public companies tends to rise as holdings move over from the private segment. This can be seen in the 'IPO windows' of 2004-07 and 2013-15, when sentiment towards healthcare stocks was buoyant. HBMN then tends to take profits from the newly public companies and reinvest in private holdings, as seen in 2008-12. The recent global market volatility may result in decreased IPO appetite and HBMN's private weighting is likely to rise again over the medium term.

In the short term the impact of the expected shift is likely to be small, however, as the managers have a keen focus on valuation and will avoid any opportunities they deem to be overpriced. At the end of a healthcare IPO cycle the tendency is for those companies with decent proof of principle to have gone public already. However, as non-specialist investors reduce their weighting in healthcare – and particularly biotech – stocks as a result of increased risk aversion, HBMN's managers look forward to their target companies becoming more affordable. They note that only 2% of the portfolio is currently invested in pre-clinical or Phase I companies, and that this could grow to 10-15% over the next couple of years as HBMN reinvests cash from exits in promising earlier-stage companies.

Exhibit 3: Evolution of public and private exposure since inception



Source: HBM Healthcare Investments, Edison Investment Research. Note: Percentage is at 31 March year-ends. Private companies are those held directly, not via funds. The balance is in private equity funds, cash and other assets and/or liabilities.

The valuation of HBMN's public holdings directly reflects their market value, meaning that when the public weighting is high, the company's stated net asset value is closer to the realisable value of the assets. Private holdings are conservatively valued, with most holdings carried at cost even where there have been positive clinical developments. Those that do not deliver on their plan are written down in steps of 25% at a time. Private holdings will be revalued if there is a financing round that gives a new valuation (for example, a financing round for Cathay Industrial Biotech in December 2015 saw the carrying value increased by 218%).

If companies have meaningful sales and are profitable, they will be valued on the basis of peer multiples using comparable listed companies, although a discount is still applied. The managers illustrate this with the example of Ellipse Technologies: the $14m investment was valued at cost until the company had meaningful revenues, and was then revalued upwards in steps to $33m at the point at which the company was sold to NuVasive in January, netting the fund c $100m.

Milestones (that is, future payments potentially due to earlier-stage investors such as HBMN after a company has been floated or sold) are valued on a probability weighting based on industry statistics, with this figure discounted for time at 11% a year.

Current portfolio positioning

At 31 December 2015 HBMN had disclosed positions in 14 private companies, 12 private equity funds and 29 public companies (eight of which had begun as private holdings). The split between private/funds/public was 14%/12%/67%. In terms of capital allocation, the majority of assets (60.6%) were invested in the top 12 holdings (nine public, two private and one fund), while a total of 28 investments were valued at more than CHF10m. The managers note that the number of holdings may grow as the portfolio matures, with some profits from larger public holdings recycled into smaller unquoted positions.

Skyepharma (see The managers' view, above) is by far the largest holding, at more than 15% of the portfolio, and accounts for the majority of the fund's 18% exposure to respiratory diseases. At 31 December the largest clinical exposure was to oncology, at 23% – this was up from 16% at the previous quarter-end, attributable largely to an increase in the allocation to major biotech stock Incyte. However, the managers say they are largely agnostic as to clinical indication (Exhibit 4), preferring to focus on the proposition, risk and value drivers of individual investments.

Exhibit 4: Portfolio sector positions (%)

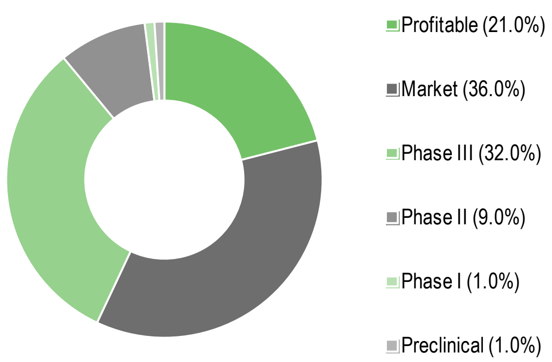
	Portfolio end December 2015	Portfolio end December 2014	Change
Oncology	23.0	10.0	13.0
Respiratory diseases	18.0	16.0	2.0
Metabolic diseases	11.0	13.0	-2.0
Medtech/diagnostics	10.0	10.0	0.0
Anti-infectives	9.0	25.0	-16.0
Pain management	8.0	11.0	-3.0
Ophthalmology	7.0	7.0	0.0
Central nervous system	4.0	N/S	N/A
Other	10.0	8.0	2.0
	100.0	**100.0**	

Source: HBM Healthcare, Edison Investment Research. Note: N/S – not separately stated at this date.

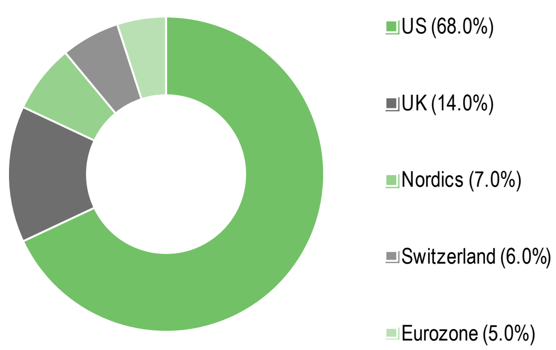
As seen in Exhibit 5 below, the portfolio is currently heavily weighted towards companies that have products on or close to the market. Geographically, alongside the US (which dominates most biotech and many broader healthcare funds) there is a significant weighting to Europe, where the managers point out that assets are often priced at a discount to US peers.

Exhibit 5: Portfolio breakdown by stage and currency as at 31 December 2015

Portfolio analysis by stage*



Portfolio by region/currency



Source: HBM Healthcare Investments, Edison Investment Research. Note: *Classified by most advanced stage.

The portfolio of private equity funds carries c CHF50m in further commitments, or about 34% of the amount invested. However, much of the funds portfolio is maturing, with vintages of 2001-05, and these older funds are returning capital that can be used to fund commitments to newer holdings. The managers say they expect the capital allocation to funds to remain steady at around 10%, although the value of the funds portfolio may exceed this level because of strong performance.

Recent investments and exits

One of the more significant recent developments is the sale of Ellipse Technologies, a private company that was HBMN's eighth-largest investment at 31 December, to NuVasive. Ellipse specialises in minimally invasive treatment of spinal and limb disorders. The sale was announced in early January 2016 and closed in mid-February, resulting in net proceeds of $90m for HBMN's direct holding compared with a carrying value of $33.8m at 31 December 2015. (A further indirect stake was held by the MedFocus fund, one of HBMN's fund investments). A revenue-based milestone could bring in a further $8m in 2017.

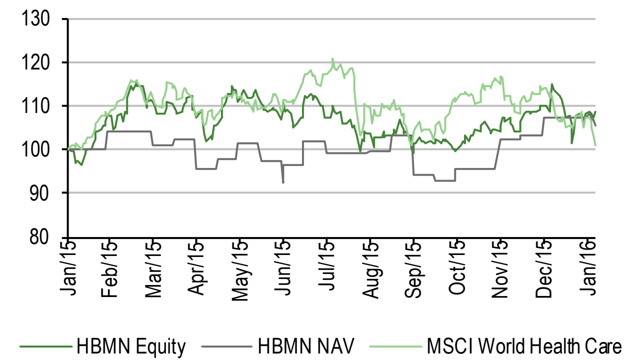
In the public portfolio, a large holding in antibiotic/antifungal specialist Basilea Pharmaceutica (10.6% of the portfolio at the 31 March 2015 year-end; previously a private holding) was reduced dramatically during the fourth quarter of 2015 and exited entirely in January 2016. HBMN had held Basilea since 2001 when it was a private company, and calculates that over the life of the investment it achieved a capital-weighted annualised rate of return of more than 15%.

New private investments in 2016 have been made in retinal disease and eye cancer specialist Iconic Therapeutics ($7.5m), and cancer immunotherapy stock ARMO BioSciences ($10m). In both cases HBMN has participated in these financing rounds alongside other partners. This is a tried-and-tested route for the fund, with past funding tie-ups including Ophthotech (co-lead with SV Life Sciences; the company floated in 2013 but is still held in the public portfolio) and Paratek Pharmaceuticals (now the ninth-largest holding), where HBMN was co-lead with Omega Funds.

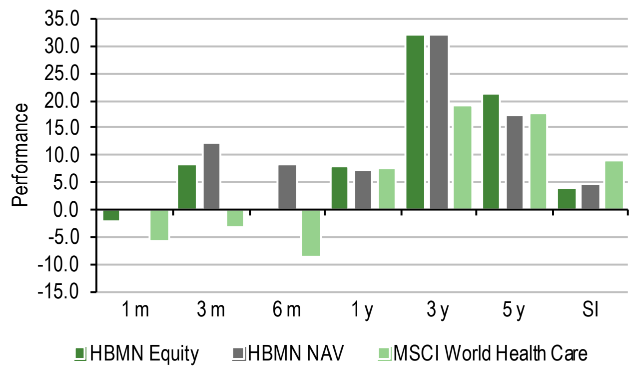
Performance: Differentiated by private/public split

Exhibit 6: Investment trust performance to 31 January 2016

Price, NAV and benchmark total return performance, one-year rebased



Price, NAV and benchmark total return performance (%)



Source: Thomson Datastream, Edison Investment Research. Note: Three and five-year and since inception (SI) performance figures annualised. Inception date is 14 February 2008, when the fund was first listed on the Swiss stock exchange.

Exhibit 7: Share price and NAV total return performance, relative to indices (%), in CHF

	One month	Three months	Six months	One year	Three years	Five years	SI
Price relative to MSCI World Health Care	4.0	12.0	9.8	0.6	36.7	14.8	(32.4)
NAV relative to MSCI World Health Care	6.0	16.2	18.3	(0.1)	36.9	(1.8)	(27.7)
Price relative to NASDAQ Biotechnology	21.3	26.9	34.7	16.4	10.4	(17.9)	(58.7)
NAV relative to NASDAQ Biotechnology	23.7	31.6	45.1	15.6	10.6	(29.8)	(55.8)
Price relative to FTSE All Share	2.7	17.8	11.8	7.7	103.5	106.9	38.0
NAV relative to FTSE All Share	4.7	22.2	20.4	7.0	103.7	76.8	47.8

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-January 2016. Geometric calculation. SI is from 14 February 2008.

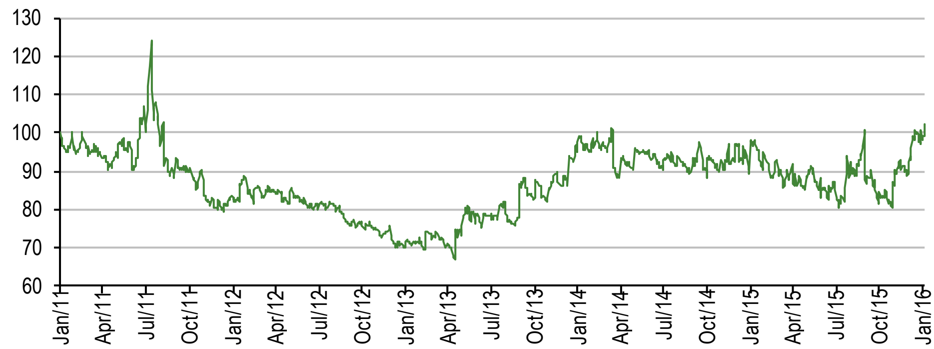
HBMN's holdings in private companies (c 26% in direct and fund holdings at 31 December) as well as listed equities mean its performance will tend to be differentiated from market indices. Private holdings are valued conservatively, and upward revaluations happen only as a result of specific events (see page 6), so the short-term NAV volatility of these assets is limited, although write-downs may occur in the case of negative clinical developments.

Over one year to 31 January HBMN has performed in line with the MSCI World Health Care Index (Exhibit 6). It has markedly outperformed the Nasdaq Biotech Index, which sold off sharply at the start of 2016 as investor risk-aversion increased. Performance over periods of less than one year is also ahead of all indices (including the FTSE All-Share, which we use as a proxy for general market exposure because of its relevance to UK investors [Exhibit 7]). Performance has been particularly strong over three years, although less so versus indices over five years and since inception.

Returns in 2015 were boosted by the initial public offering of Advanced Accelerator Applications (now the second-largest holding), which saw an immediate 85% uplift to the previous carrying value, and by a financing round for Cathay Industrial Biotech, which resulted in an upwards revaluation of more than 200%. Largest holding Skyepharma also performed strongly in the second half of 2015, up 42% in sterling terms. Since the start of 2016 a further uplift has come from the sale of Ellipse Technologies at a 7.4-8.0x multiple of invested capital.

Exhibit 8 below shows HBMN's NAV performance relative to the MSCI World Health Care Index over five years. While the fund's partly private portfolio means comparisons with a quoted index are of limited relevance – particularly given the dominance of larger, established companies in the benchmark – it is interesting to note that a flatter period of relative performance since late 2013 has coincided with a higher proportion of public holdings in the portfolio. (See page 6 for an illustration of the evolution of the public/private split over time.) Public exposure in the portfolio is partly cyclical as it tends to rise in buoyant equity markets where there is more demand for IPOs. A strong period of relative NAV performance since December 2015 is partly attributable to the revaluation of Cathay Industrial Biotech in December and the sale of Ellipse Technologies (see pages 7-8) in January.

Exhibit 8: NAV performance relative to MSCI World Healthcare over five years



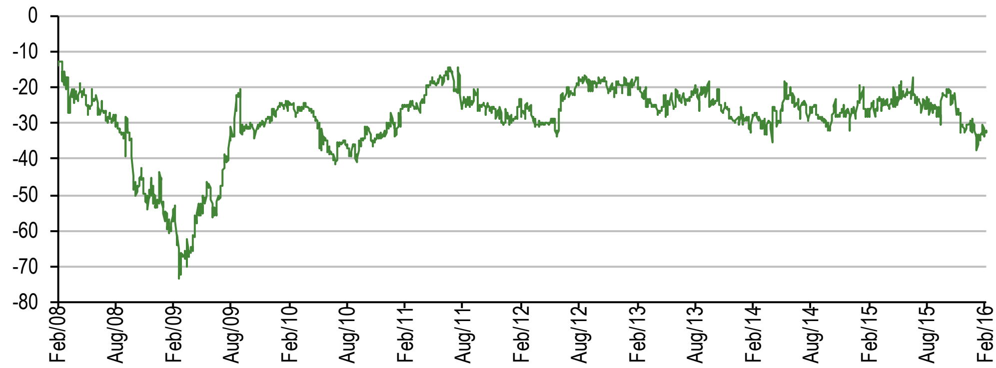
Source: Thomson Datastream, Edison Investment Research. Returns in CHF.

Discount: Wide but with support from buybacks

At 25 February HBMN's shares traded at a 27.4% discount to cum-income net asset value. This was largely in line with the averages over one, three and five years (25.8%, 25.6% and 24.7% respectively). As noted in the peer group section below, the wide discount may be partly attributable to the focus on private investments; private equity funds in general fell to large discounts during and after the financial crisis, and HBMN was not unaffected by this (see Exhibit 9). However, the valuation methodology used for private investments is relatively conservative, and exits from private holdings via IPO or trade sale have tended to be at uplifts to the carrying value of investments.

HBMN aims to manage the discount through an active repurchase programme (see Capital structure, below), particularly when the level is significant at 20-30%. Cash holdings within the portfolio (which are boosted from time to time by exits from investments, such as the recent trade sale of Ellipse Technologies) may be used to fund buybacks to avoid having to sell investments at what might be sub-optimal valuations.

Exhibit 9: Share price premium/discount to NAV (including income) since inception



Source: Thomson Datastream, Edison Investment Research. Note: Inception is date of HBMN listing.

Capital structure and fees

HBM Healthcare Investments Ltd is domiciled in Zug, Switzerland, and listed on the Swiss SIX Exchange. It invests via a wholly owned subsidiary company, HBM Healthcare Investments (Cayman) Ltd. At 31 December 2015 the company had 7.44m shares in issue.

In June 2015 HBMN announced the issue of two tranches of bonds totalling CHF100m. The first tranche of CHF50m runs for six years with a coupon of 2%, while the second tranche of CHF50m runs for eight years with a coupon of 2.5%. Together the two bond issues equate to gross gearing of 10.1% at 31 December 2015, or net gearing of 4.9% taking cash and equivalents into account.

HBM Partners, which acts as investment adviser to HBMN, is paid an annual management fee of 0.75% of net assets and 0.75% of market capitalisation. A performance fee may also be payable subject to certain conditions. The fee of 15% of outperformance becomes due if the year-end (31 March) NAV is more than 5% above the level at which a performance fee was last paid, calculated by deducting the highest net assets that were used as the calculation basis of the last performance fee paid from the net assets at the balance sheet date. Net assets are adjusted in line with changes to the number of shares in issue and any dividends that are paid out. A performance fee of CHF47.4m, equivalent to c 4.0% of total assets, was paid in respect of FY15; this was the first year since 2007 (before HBMN was a listed company) that a fee had been paid. The new high-water mark is CHF141.70 per share. The directors receive a performance fee of 1% of the total performance fee paid, deducted from the amount payable to the investment adviser. We calculate ongoing charges for the fund, based on fees paid in FY15 and the average of total assets at the start and end of the year, to be 1.5% excluding or 6.0% including the performance fee.

As part of its strategy to manage discount volatility, HBMN undertakes share buybacks. Under the latest authority granted in 2014, the company may buy back up to 800,000 shares (c 10% of outstanding shares at the time the authority was granted). In FY15, 245,500 shares were bought back under this authority and a further 132,003 were repurchased in the first three quarters of FY16 (to 31 December 2015).

Dividend policy and record

Early-stage healthcare and biotechnology companies tend to be focused on clinical research and development, and even among those that are generating profits from products on the market, few pay a dividend. However, as part of a more 'shareholder friendly' approach, in FY13 HBMN adopted a policy of distributing cash from its capital reserves as a 'dividend', which, together with share buybacks (see above), is aimed at returning 5-8% a year to shareholders, depending on underlying portfolio results and the liquidity situation.

In the policy's three years of operation so far (FY13 to FY15), HBMN has paid distributions of CHF1.50, CHF3.00 and CHF5.00, approximating to dividend yields of 3%, 4% and 5% at the point of declaration. Distributions are declared with the annual results in May, and paid following approval at the shareholders' meeting in late June. Because the distribution does not relate to portfolio revenues, it is not possible to forecast the likely magnitude of the FY16 distribution. However, HBMN has stated it intends to continue with the distribution policy, and with capital reserves amounting to CHF39.45 per share at 31 December 2015, payouts should be sustainable even in the event of a capital loss being reported at the full year. Based on the FY15 distribution and the 25 February share price of CHF97.45, the shares have a current yield of 5.6%.

Peer group comparison

There are relatively few specialist closed-end healthcare and biotech funds available to UK investors. Exhibit 10 below shows the four UK investment trusts (two specialising in biotech and two healthcare generalists), as well as Switzerland-listed BB Biotech and HBMN. All data is shown in CHF terms. None of the funds is directly comparable with HBMN; International Biotechnology Trust has a proportion of its portfolio (c 10%) in unquoted companies but specialises in the biotech sector, whereas HBMN has a broader healthcare focus.

Exhibit 10: Selected healthcare and biotech peer group at 18 February 2016

% unless stated	Market cap CHFm	TR 1 Year	TR 3 Year	TR 5 Year	Ongoing charge	Perf. fee	Discount (ex-par)	Net Gearing	Dividend yield (%)	Sharpe 1y (NAV)	Sharpe 3y (NAV)
HBM Healthcare Investments AG	**756.5**	**18.7**	**171.6**	**162.1**	**1.5**	**Yes**	**(32.6)**	**104.9**	**5.6**	**0.4**	**1.6**
BB Biotech AG	2,749.2	(17.1)	121.5	248.2	1.1	No	(5.9)	101.0	6.4	(0.8)	1.1
Biotech Growth Trust	514.9	(9.2)	107.8	261.6	1.2	Yes	(4.9)	111.0	0.0	(0.6)	1.1
International Biotechnology Trust	234.7	(7.0)	101.2	179.9	1.5	Yes	(12.0)	100.0	0.0	(0.5)	1.1
Polar Capital Glb Healthcare	275.5	4.4	47.7	99.5	1.1	Yes	(6.2)	100.0	2.3	(0.5)	1.1
Worldwide Healthcare	1,145.1	4.9	97.4	159.8	1.0	Yes	(4.4)	109.0	0.8	(0.2)	1.4
Simple average	**946.0**	**(0.9)**	**107.9**	**185.2**	**1.2**		**(11.0)**	**104.3**	**2.5**	**(0.4)**	**1.2**
Weighted average		**(5.7)**	**117.7**	**210.1**	**1.2**		**(9.3)**	**104.0**	**4.7**	**(0.5)**	**1.2**
HBMN rank on peer group	**3**	**1**	**1**	**4**	**2**		**6**	**3**	**2**	**1**	**1**

Source: Morningstar, Edison Investment Research. Performance data as at 31 January 2016. Note: TR=NAV total return in CHF. Sharpe ratio is a measure of risk-adjusted return. The ratios shown are calculated by Morningstar for the past 12- and 36-month periods by dividing a fund's annualised excess returns over the risk-free rate by its annualised standard deviation. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared).

Over one and three years to 31 January, HBMN has produced the highest NAV total returns in the group. This is partly a reflection of a sharp sell-off in the biotech sector during January 2016, the magnitude of which was sufficient to turn all the biotech funds' one-year returns negative. HBMN also ranks first for risk-adjusted performance, as measured by the Sharpe ratio, over one and three years. Over five years HBMN's NAV total return ranks fourth out of six, but is the highest of the non-biotech specialists.

Ongoing charges are above average for the peer group, although should be noted that most of the peers are investing solely in public companies. The dividend yield is the second-highest in the group. In common with its compatriot BB Biotech, HBMN has a high distribution policy, with 'dividends' paid out of capital rather than reflecting portfolio income. Gearing of c 5% net is in line with the peer group average. HBMN's discount to NAV is the widest in the peer group by some margin. This may reflect larger discounts generally for private equity-focused funds (at 18 February the average discount for funds in the AIC's Private Equity sector, excluding 3i, was 26.4%), an assertion supported by the fact that International Biotechnology Trust is the only other fund in the group on a double-digit discount to NAV. HBMN's private equity weighting is currently low in historical context but is likely to rise.

The board

HBMN's policies state that it must have a board of directors comprising at least five members, all of whom must be shareholders. The company currently has six non-executive directors, all with specific knowledge of the pharmaceutical and biotechnology sectors. The chairman, Hans Peter Hasler, has been on the board since 2009. He has spent his career involved in the business and marketing side of healthcare, including at Wyeth Pharmaceuticals and Biogen-Idec. Vice-chairman Dr Heinz Riesenhuber has been a director since the company's inception in 2001. He has a PhD in chemistry and is a German member of parliament and former minister for scientific research. Dr Rudolf Lanz has served on the board since 2003. His background is in law and corporate finance and he is a member of the audit and nominations committees. Robert A Ingram, a director since 2006, is a former CEO and chairman of Glaxo Wellcome, while Dr Eduard E Holdener, appointed in 2008, is a medical doctor specialising in oncology and has held various senior clinical roles in the Roche group of companies. The newest director, Mario G Giuliani, joined the board of HBMN in 2012 and is the president and CEO of Giuliani SpA, an Italian consumer healthcare company.

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