

# HBM Healthcare Investments

## Potential for further outperformance

**HBM Healthcare Investments (HBMN) is a Switzerland-listed closed-end fund investing in listed and private healthcare companies globally. In a volatile stock market environment, the fund has performed strongly in NAV total return terms, rising to the top of its peer group over one and three years. Factors behind the positive performance include strong exits/IPO values from private companies, premium takeovers of listed stocks, good clinical newsflow from some holdings and the lower volatility of private investments. The managers point to approaching clinical catalysts for a number of the top holdings, where early data suggests newsflow may be positive, leading to substantial (although by no means guaranteed) upside potential. The shares currently yield 5.5%.**

12 months ending	Share price (%)	NAV (%)	MSCI World Healthcare (%)	NASDAQ Biotech (%)	FTSE All-Share (%)
31/10/12	18.3	8.6	28.4	44.5	17.2
31/10/13	42.3	55.8	28.6	51.9	19.1
31/10/14	37.0	42.4	31.6	54.2	6.9
31/10/15	6.6	0.6	9.4	12.9	1.8
31/10/16	14.4	11.3	(6.8)	(20.8)	(11.0)

Note: Twelve-month rolling discrete total return performance in CHF terms.

## Investment strategy: Specialists in global healthcare

HBMN is managed by HBM Partners, a specialist Switzerland-based healthcare investment manager with teams focusing on private and listed equities. Most team members have a life sciences background, so they can assess clinical as well as financial drivers of potential investments. Many of the largest listed equity positions in the portfolio were backed as early-stage private companies, a strategy the team intends to continue to follow. After a strong period of IPOs and M&A activity, the proportion of private holdings is expected to rise from the current low level of c 13%.

## Market outlook: Value and recovery potential

After a volatile 18 months caused largely by the long and bitter US presidential election campaign, most subsectors of the healthcare market have reacted positively to the Republican clean sweep. The removal of uncertainty could see a resumption of M&A activity in the sector, particularly given pharma and biotech valuations currently look fair or cheap relative to the broader world and US equity markets. The pace of scientific advance continues, and ageing populations across the world will underpin demand for healthcare products and services.

## Valuation: Widest discount in peer group

At 18 November, HBMN's shares traded at a 28.3% discount to NAV, broadly in line with short and longer-term averages of 20-30%. This is substantially the widest discount in the peer group and suggests investors may be applying a private equity-level discount to a portfolio that is currently more than 50% invested in listed assets. A high distribution policy and a share buyback programme aim to limit the discount; further narrowing could also be achieved if HBMN can sustain its recent strong performance versus peers.

## Investment companies

21 November 2016

**Price** CHF100.1  
**Market cap** CHF710.7m  
**AUM** CHF990.9m

NAV\* CHF139.6

Discount to NAV 28.3%

\*Including income. Price data at 18 November 2016. NAV data at 15 November 2016.

Yield 5.5%

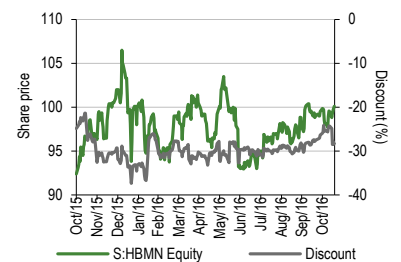
Ordinary shares in issue 7.1m

Code HBMN

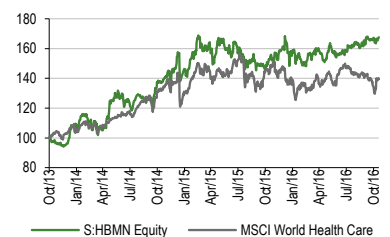
Primary exchange SIX

AIC sector N/A

## Share price/discount performance



## Three-year performance vs index



52-week high/low CHF106.5 CHF93.0

NAV\*\* high/low CHF149.8 CHF131.5

\*\*Including income.

## Gearing

Gross\* 10.2%

Net cash\* 0.1%

\*As at 30 September 2016.

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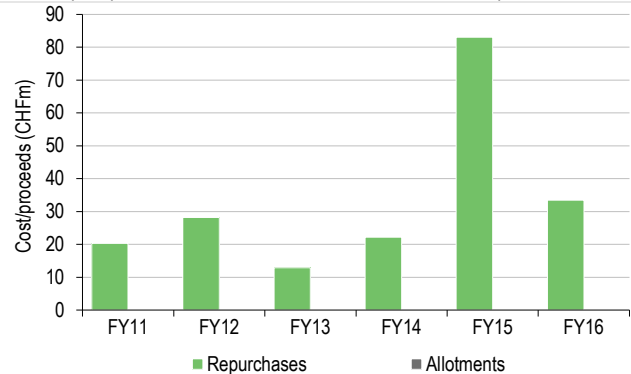
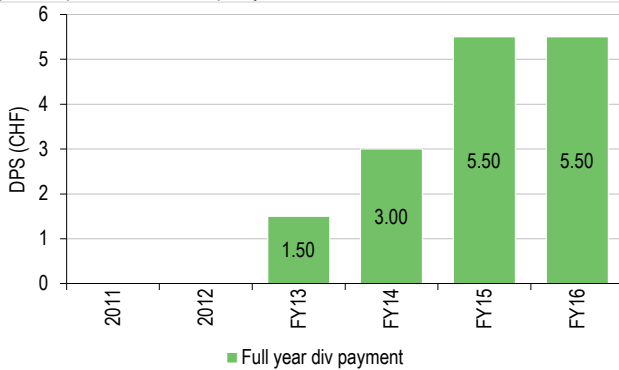
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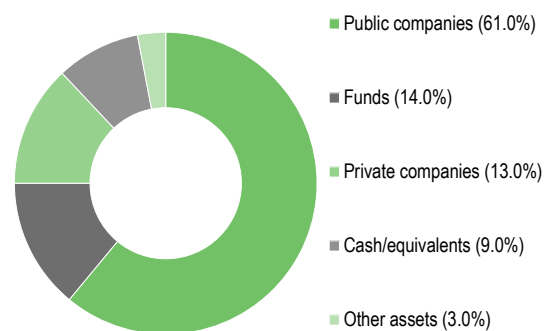
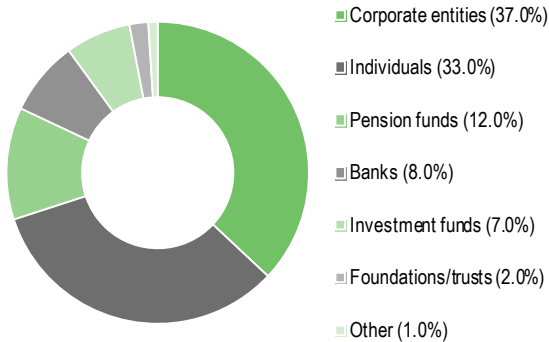
### Exhibit 1: Fund at a glance

Investment objective and fund background				Recent developments	
HBM Healthcare Investments (previously HBM BioVentures, renamed in 2012) is a Swiss investment company that aims to generate long-term capital gains by investment in private and public companies in the human medicine, biotech, medtech and diagnostics sectors, and related areas. It invests worldwide, predominantly in later-stage private companies, either directly or through funds, and many of its publicly listed holdings began as private equity investments.				<ul style="list-style-type: none"> <li>28 October 2016: Quarterly report to 30 September. NAV total return for FY17 to date (from 31 March) +3.3%; share price TR +3.8%.</li> <li>18 October 2016: HBM Healthcare Investments leads financing round for True North Therapeutics, investing \$10m of \$45m equity finance raised.</li> <li>4 October 2016: New share buyback programme launched for up to 730,000 shares (10% of total shares issued) between October 2016 and June 2019.</li> </ul>	
Forthcoming		Capital structure		Fund details	
AGM	June 2017	Ongoing charges	1.6%	Group	HBM Partners
Annual results	May 2017	Net cash	0.1%	Managers	Team managed
Year end	31 March	Annual mgmt fee	0.75% NAV + 0.75% mkt cap	Address	Bundesplatz 1, 6300 Zug, Switzerland
Dividend paid	End June/early July	Performance fee	Yes – see page 7	Phone	+41 41 710 75 77
Launch date	July 2001 (listed Feb 2008)	Fund life	Indefinite	Website	<a href="http://www.hbmhealthcare.com">www.hbmhealthcare.com</a>
Continuation vote	No	Loan facilities	CHF100m bond issue		

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 October 2016. The FY15 figure includes an issue of put options, which saw an additional 564,897 shares repurchased.	



Shareholder base (as at November 2016)	Portfolio exposure by investment type (as at 30 September 2016)
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Top 10 holdings (as at 30 September 2016)			Portfolio weight %	
Company	Country of listing	Sector	30 September 2016	30 September 2015*
Advanced Accelerator Applications**	France	Imaging and radiotherapy	12.6	4.6
Vectura	UK	Respiratory diseases	12.4	N/A
Cathay Industrial Biotech***	China	Industrial polymers	4.3	1.5
Incyte	US	Oncology	3.9	3.0
Pacira Pharmaceuticals**	US	Pain management	3.7	4.8
Nordic Biotech	Denmark	Fund	3.5	3.8
Genmab	Denmark	Oncology	3.4	2.8
HBM BioCapital II	Jersey	Fund	3.2	2.7
Neurocrine Biosciences	US	Neurological & endocrine based diseases	2.8	0.9
Ophthotech**	US	Ophthalmology	2.6	3.3
<b>Top 10 (% of portfolio)</b>			<b>39.8</b>	<b>53.4</b>

Source: HBM Healthcare Investments, Edison Investment Research, Morningstar. Note: \*N/A where not in September 2015 top 10. \*\*Originally held in private portfolio. \*\*\*Private company.

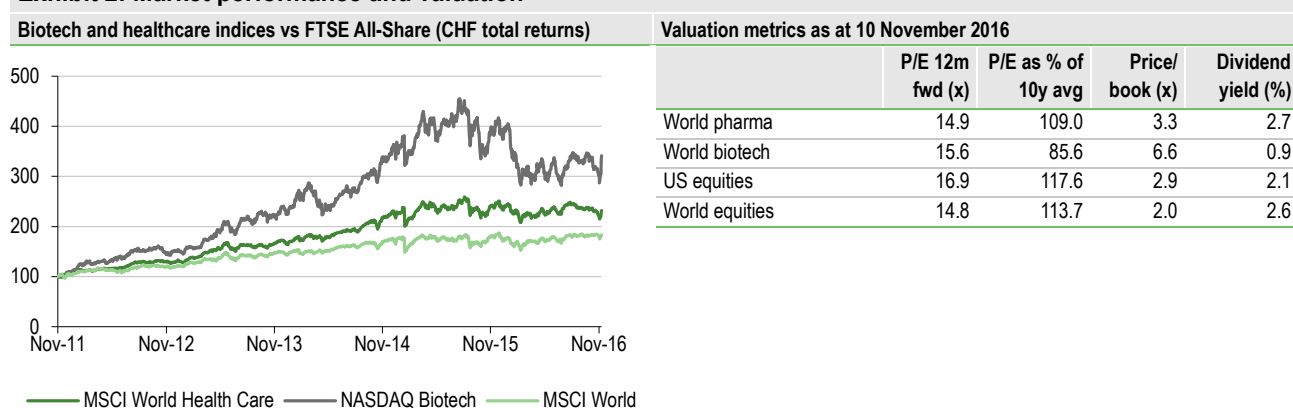
## Market outlook: End of uncertainty sparks recovery

The protracted US presidential election campaign has weighed on global healthcare and biotech stocks for more than 12 months, given fears over Democrat attitudes to high-priced drugs and the possibility of a Republican administration reversing healthcare reforms. Now that the contest is concluded and Donald Trump is the president-elect, pharma and particularly biotech stocks have recovered sharply, along with health insurers, while healthcare services stocks have sold off.

The right-hand table below shows valuations for pharma and biotech are broadly in line with global equities on a forward P/E basis, and both areas are cheaper than the US market. Biotech also looks cheap relative to history; while forward P/E ratios for pharma stocks are above the 10-year average, they are 22.8% below the 10-year high, compared with 4.5% and 7.5% for US and world equities respectively. Pharmaceutical stocks also offer a higher average yield than the US or world markets.

While the Trump victory may have negative ramifications for some areas of the global stock market (particularly emerging markets), the removal of uncertainty and the possibility of a more market-focused approach to healthcare in the US – the largest global market – should provide conditions in which many subsectors can continue to recover. M&A activity may also pick up in the near term, in both the public and private markets, given the relatively attractive valuations on offer.

**Exhibit 2: Market performance and valuation**



Source: Thomson Datastream, Edison Investment Research. Valuations using Datastream indices.

## Fund profile: Public/private global healthcare portfolio

HBMN was formed in 2001 to invest across healthcare and biotech sectors. Listed on the SIX Swiss exchange since February 2008, initially as HBM BioVentures, in 2012 it changed its name to HBM Healthcare Investments to reflect its broader healthcare focus and its investments in public as well as private companies. At 30 September 2016, the portfolio was 61% invested in listed equities, although more than 57% of these had begun in the private portfolio.

Managed from Zug, Switzerland by HBM Partners (led by CEO Dr Andreas Wicki and CFO Erwin Troxler), the fund invests globally and across healthcare sectors. The MSCI World Health Care index is used as a reference, although in line with its European roots, HBMN is underweight the US (43% versus 67% at 30 September) and overweight Europe compared with the index. While it retains a primary aim of achieving capital growth, since 2013 the fund has also followed a high distribution policy, and currently yields 5.6%. With CHF101m of cash on its balance sheet at 30 September (10.3% of total assets), the managers point out that the fund has sufficient reserves to underpin the dividend as well as finance new investments. The high distribution policy is designed partly as a mechanism to limit the fund's discount to NAV; it also employs share buybacks of 2-3% a year.

## The fund manager: HBM Partners

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### The manager's view: Many catalysts on the horizon

HBMN's managers point to a number of clinical catalysts over the coming months that could provide significant upside potential for the portfolio. While favourable outcomes from clinical trials are not a given, CEO Andreas Wicki points out that many of the current trials are late stage and have had positive data in earlier phases, which increases the likelihood of success.

Top holding Advanced Accelerator Applications could see its Lutathera treatment for neuro-endocrine tumours in the digestive tract, approved by the FDA as soon as 28 December. Wicki says the market for the drug will be bigger than first thought, with peak potential for \$1bn a year in sales. Next-largest position Vectura is hoping for approval for its generic version of GlaxoSmithKline's asthma blockbuster Advair in May 2017, while Ophthotech, a former private holding that floated in 2014, has Phase III trial data for its wet age-related macular degeneration treatment due imminently. Pacira Pharmaceuticals is also in Phase III trials for its Exparel pain medication for the indications 'nerve block' and 'total knee arthroplasty'; results from this are also expected by early 2017. Wicki sees c 50% share price upside for all these companies in the event of successful outcomes. For earlier-stage private companies such as ARMO Biosciences, ObsEva and True North Therapeutics, HBMN's managers see potential IPOs as the value drivers, whereas the public equity portfolio is positioned and should continue to benefit from continued M&A activity in the sector.

With c 10% cash in the portfolio, the managers are looking to increase the weighting in earlier-stage private companies. Wicki says the team aims to make five or six investments of c CHF10m each in companies that have significant potential but as yet unvalidated potential; keeping the investment small means that individual failures will have limited impact on the overall portfolio, while the upside from ultimately successful products backed at an early stage could be considerable.

Away from clinical developments, the managers expect that the IPO market – which all but closed down in the run-up to the US election, where all sides were vocal about the healthcare sector – could pick up in 2017, providing the possibility of a profitable exit from private holdings.

## Asset allocation

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### Investment process: Centred on private equity approach

HBMN's investment universe is global and ranges across several areas of healthcare, principally biopharmaceuticals, generic drugs, medical devices and diagnostics. HBM Partners' investment professionals are split across public and private equity teams, with most of the team members having an academic or professional background in life sciences. Weekly meetings involving both teams allow the sharing of information on the latest clinical developments and competitive opportunities and threats. Both teams can draw on their own global industry networks and may also make use of the expertise of external business advisers.

While HBMN's portfolio is currently tilted towards listed investments, the managers argue that the main investment driver is its private equity focus. This is evident in the fact that more than half the listed holdings (by value at 30 September) began in the private equity portfolio. Private investments may be made directly or via funds. The fund's portfolio was originally put in place to gain exposure to the US market, but is now used more as a way of accessing 'company builders' and start-ups coming out of major research universities, as well as emerging markets such as China.

Public holdings are valued based on their share price, while most private holdings are carried at cost, or revalued based on new financing rounds. Catalysts for reappraisal of investments may include scientific innovations or the results of clinical trials.

## Current portfolio positioning

Calendar year 2016 has been a period of change for the HBMN portfolio, largely driven by M&A activity. Towards the end of FY16, Ellipse Technologies, the largest private holding, was sold to NuVasive, and the largest public holding, Skyepharma, agreed a merger with Vectura Group. These two transactions brought HBMN more than CHF100m in cash, which was boosted in the first half of FY17 by takeover bids for Relypsa, Medivation and Anacor (collectively CHF26m at FY16).

The proportion of the portfolio in private companies remains low in historical terms, at 13% (30 September) versus an average of 35.1% since the fund was listed in 2008. This is partly owing to the sale of Ellipse and the IPO in late 2015 of Advanced Accelerator Applications, then the largest private holding and now the largest position in the public portfolio. The managers note that they continue to seek new private investment opportunities, and in October 2016 HBMN announced a new CHF10m investment in San Francisco-based rare disease specialist True North Therapeutics. HBMN's portfolio is heavily weighted (c 87%) to companies with products on or close to the market, but the managers say the proportion in early-stage companies (currently only 3%) could rise, but will be limited to 10-15% of the portfolio, with individual new positions likely to be sub-CHF10m (c 1% or less) to contain risk.

**Exhibit 3: Portfolio sector positions (%)**

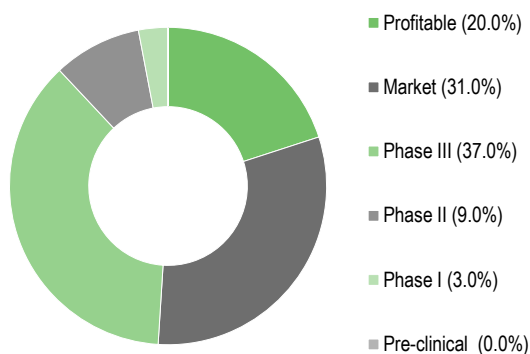
	Portfolio end September 2016	Portfolio end September 2015	Change (pts)
Oncology	30.0	16.0	14.0
Respiratory diseases	15.0	21.0	-6.0
Metabolic diseases	7.0	6.0	1.0
Medtech/diagnostics	7.0	13.0	-6.0
Infectious diseases	6.0	19.0	-13.0
Ophthalmology	6.0	4.0	2.0
CNS disorders	6.0	N/A	N/A
Pain	5.0	6.0	-1.0
Others	18.0	15.0	3.0
	<b>100.0</b>	<b>100.0</b>	

Source: HBM Healthcare Investments, Edison Investment Research

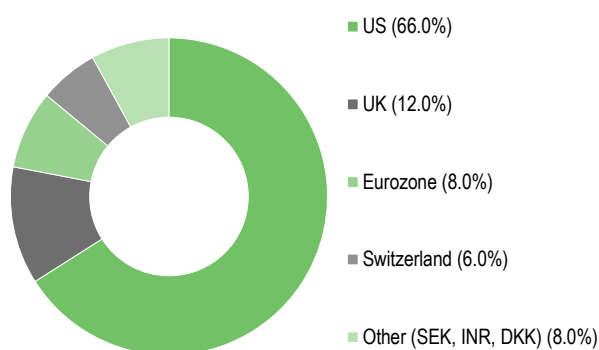
As shown in Exhibit 3, oncology exposure has risen sharply over the past 12 months, largely as a result of strong performance from major holdings Advanced Accelerator Applications and Genmab, but boosted by new or increased positions in Tesaro, Bristol-Myers Squibb and Argenx (collectively CHF17.5m at 30 September). Respiratory disease exposure declined after the Skyepharma merger and the sale of a position in Vertex, while medtech/diagnostics and infectious disease exposure fell respectively after the sale of Ellipse to NuVasive, and the disposal of a long-standing holding in Basilea Pharmaceutica. Completely new holdings in H117 include private Canadian company Vitaeris (inflammatory diseases), UK epilepsy play GW Pharmaceuticals, US rare diseases specialist Sarepta Therapeutics and ophthalmology-focused Nicox (France) and Alimera Sciences (US).

**Exhibit 4: Portfolio breakdown by stage and currency as at 30 September 2016**

Portfolio analysis by stage\*



Portfolio by region/currency

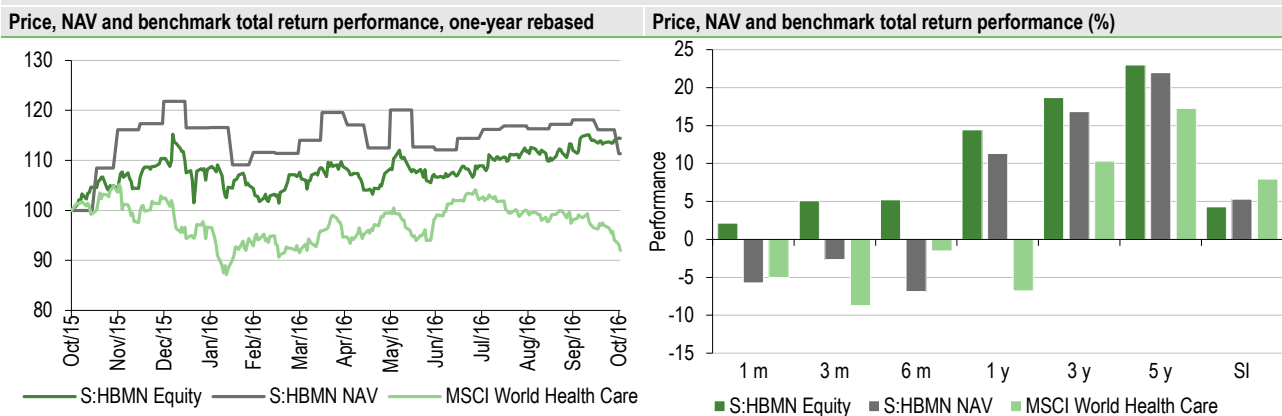


Source: HBM Healthcare Investments, Edison Investment Research. Note: \*Classified by most advanced stage.

## Performance: Outperforming broader market

HBMN has performed strongly over one, three and five years to 31 October (Exhibit 5), both in absolute terms and relative to the MSCI World Health Care index. A 4% fall in NAV in the second half of October, after largest holding Advanced Accelerator Applications' share price declined by 10%, has dragged shorter-term NAV returns into negative territory. Second-largest holding Vectura Group, which is listed in the UK, has also weighed on performance in CHF terms because of the weakness of sterling. In the six months to 30 September (the first half of HBMN's financial year), double-digit positive returns (c 10-30%) were achieved by top 10 names Incyte, Genmab, Nordic Biotech fund, Neurocrine Biosciences and Ophthotech, while Pacira Pharmaceuticals fell c 35%. Relative to indices (Exhibit 6), HBMN's diversification across healthcare sectors has helped it recently to outperform the narrower NASDAQ Biotech index, which was volatile in the run-up to the US election on fears over political pressure on drug pricing. Its holdings in unquoted investments (27% across funds and direct holdings in private companies), whose valuations are periodic and less affected by market noise, may have assisted its outperformance of the broader healthcare index. In sterling terms HBMN's share price and NAV total returns are +44.3% and +40.3% over 12 months.

**Exhibit 5: Investment trust performance in CHF to 31 October 2016**



Source: HBM Healthcare Investments, Thomson Datastream, Edison Investment Research. Note: Three and five-year and since inception as a listed fund (SI, 14 February 2008) performance figures annualised.

**Exhibit 6: Share price and NAV total return performance, relative to indices (% , all in CHF)**

	One month	Three months	Six months	One year	Three years	Five years	SI
Price relative to MSCI World Health Care	7.5	15.2	6.9	22.8	24.6	27.0	(25.9)
NAV relative to MSCI World Health Care	(0.7)	6.6	(5.4)	19.4	18.9	21.8	(19.3)
Price relative to NASDAQ Biotechnology	13.0	15.8	6.4	44.4	21.2	(7.1)	(53.0)
NAV relative to NASDAQ Biotechnology	4.3	7.3	(5.8)	40.5	15.7	(10.9)	(48.8)
Price relative to FTSE All-Share	5.9	7.2	9.1	28.6	72.5	108.2	50.8
NAV relative to FTSE All-Share	(2.2)	(0.7)	(3.5)	25.1	64.6	99.6	64.1

Source: HBMN, Thomson Datastream, Edison Investment Research. Note: Data to end-October 2016. Geometric calculation.

**Exhibit 7: NAV performance relative to MSCI World Healthcare in CHF over five years**



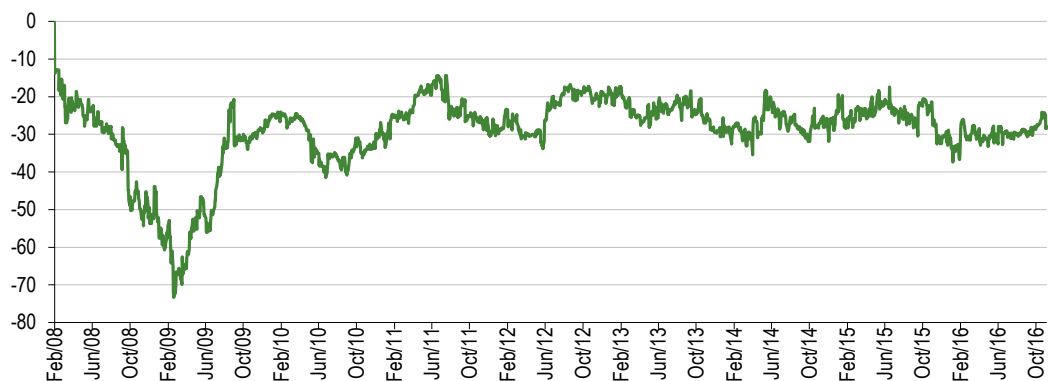
Source: Thomson Datastream, HBM Healthcare Investments, Edison Investment Research



## Discount: Stable within long-term range

At 18 November, HBMN's shares were trading at a 28.3% discount to 15 November NAV, broadly in line with the average over one, three and five years. As shown in Exhibit 8 below, the discount widened substantially during the financial crisis in 2008/9. At this time the portfolio consisted mainly of private investments (directly or via funds); listed private equity funds as a whole saw significant discount widening during this period. HBMN's discount has now been broadly stable in a range of 20-30% for the past five years, supported by share buybacks. Over this period the proportion of the portfolio invested in public companies has risen from 21% to 61% (via 68% at FY14); the persistence of the discount may reflect a lack of awareness of the portfolio changes, resulting in the continued application of a private equity-style rating. (To illustrate, the AIC Private Equity sector [ex 3i] stood at an average discount of 14.9% at 18 November, versus 4.9% for all investment trusts [ex 3i]).

**Exhibit 8: Share price discount to NAV (including income) since inception (%)**



Source: Thomson Datastream, HBM Healthcare Investments, Morningstar, Edison Investment Research.

## Capital structure and fees

HBMN is domiciled in Zug, Switzerland and listed on the Swiss SIX exchange. At 18 November 2016 it had 7.1m shares in issue. The fund has gearing of CHF100m through two tranches of secured bonds issued in 2015. This equates to gross gearing of 10.2% based on 30 September net assets; cash and equivalents mean the fund has a net cash position of 0.1%. HBM Partners is paid a management fee of 0.75% of NAV plus 0.75% of market capitalisation a year. Performance fees of 15% may also be paid if the year-end NAV is more than 5% above the last level at which such a fee was paid. No performance fee was paid in FY16, and we calculate HBMN's ongoing charges for the year to be 1.6%. Under a new authority granted in October 2016, HBMN may buy back up to 730k shares (10% of total shares issued) for cancellation; the authority runs until June 2019.

## Dividend policy and record

In common with several peers, HBMN has adopted a shareholder-friendly distribution policy aimed at rewarding investors with an element of 'yield'. This comes in the form of capital distributions, given that many healthcare and biotech companies are more focused on reinvesting profits than paying dividends. Since FY13, HBMN's policy has been to return 5-8% a year to shareholders from a combination of distributions from its capital reserves (3-5%) and share buybacks. So far under the policy, capital distributions of CHF1.50, CHF3.00, CHF 5.50 and CHF5.50 have been paid, approximating to yields of 3%, 4%, 5% and 5.5% at the time of declaration in the annual results. Distributions are paid following approval at the shareholders' meeting in late June. Based on the 18 November share price of CHF100.1, the FY16 distribution represents a dividend yield of 5.5%.

## Peer group comparison

Exhibit 9 below shows the four UK investment trusts in the AIC's specialist Biotech & Healthcare sector alongside HBMN and Swiss biotech specialist BB Biotech. All returns are in Swiss francs. Recent returns show a clear split between the three biotech funds (NAV total returns of -24.2% to -37.4%) and the three healthcare generalists (-14.8% to +6.1%), with HBMN the only fund to post a positive return over 12 months. It also ranks first over three years, but below average over five years. Risk-adjusted returns as measured by the Sharpe ratio are also among the highest over one and three years, and the c 5% capital distribution policy ranks the fund second in terms of dividend yield. In spite of this, HBMN trades at the widest discount to NAV by some margin. The fund is ungeared (net of cash). Ongoing charges are similar to the one other fund in the group (IBT) with material exposure to private companies.

**Exhibit 9: Selected healthcare and biotech peer group at 4 November 2016, in CHF terms**

% unless stated	Mkt 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)
<b>HBM Healthcare Investments</b>	<b>758.5</b>	<b>6.1</b>	<b>52.1</b>	<b>157.3</b>	<b>1.6</b>	<b>Yes</b>	<b>(24.5)</b>	<b>100</b>	<b>5.6</b>	<b>0.5</b>	<b>0.7</b>
BB Biotech	2,636.6	(37.4)	33.4	244.2	1.1	No	(2.3)	102	6.5	(1.3)	0.6
Biotech Growth Trust	350.5	(29.1)	25.0	208.8	1.0	Yes	(5.6)	109	0.0	(1.1)	0.4
International Biotechnology Trust	189.5	(24.2)	44.2	177.9	1.5	Yes	(8.9)	100	4.5*	(0.9)	0.7
Polar Capital Gbl Healthcare	221.7	(11.6)	18.3	80.9	1.0	Yes	(5.1)	100	2.2	(0.7)	0.5
Worldwide Healthcare Trust	880.4	(14.8)	42.0	149.5	0.9	Yes	(6.5)	111	0.9	(0.6)	0.8
<b>Weighted average</b>		<b>(24.7)</b>	<b>36.9</b>	<b>202.4</b>	<b>1.2</b>		<b>(7.0)</b>	<b>104</b>	<b>5.0</b>	<b>(0.9)</b>	<b>0.6</b>
<b>HBMN rank in peer group</b>	<b>3</b>	<b>1</b>	<b>1</b>	<b>4</b>	<b>1</b>		<b>6</b>	<b>4</b>	<b>2</b>	<b>1</b>	<b>2</b>

Source: Morningstar, Edison Investment Research. Note: TR=NAV total return. 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. \*Prospective yield – dividend not yet declared.

## The board

HBMN has six non-executive directors, all with specialist pharmaceutical and biotech experience. The chairman, Hans-Peter Hasler (ex-Wyeth and Biogen) has been on the board since 2009. Vice-chairman Dr Heinz Riesenhuber, a German MP and former minister for scientific research, has been a director since HBMN's inception in 2001. Dr Rudolf Lanz, who has a corporate finance and law background, was appointed in 2003, while Robert A Ingram, a former chairman and CEO of Glaxo Wellcome, has been on the board since 2006. Dr Eduard E Holdener, an oncologist, was appointed in 2008. The newest director, Mario G Giuliani, joined the board in 2012 and is president and CEO of Italian consumer healthcare company Giuliani. All of the directors are shareholders of the fund.

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