HBM Healthcare Investments

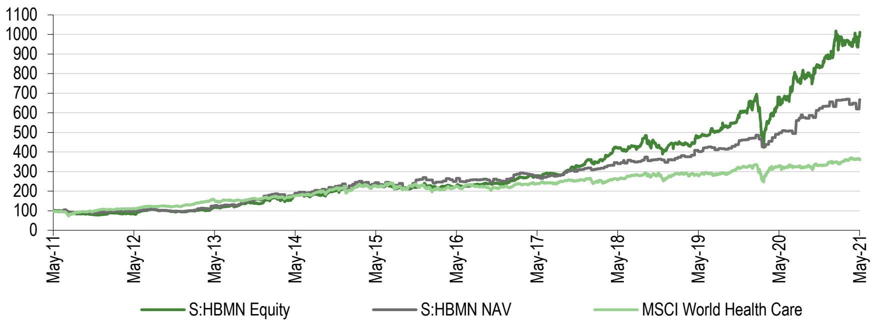
A stellar year to mark 20th anniversary

Investment companies
Biotech & healthcare

3 June 2021

HBM Healthcare Investments (HBMN) has posted record returns in its 20th anniversary year, with NAV and share price total returns of 52% and 79% respectively in Swiss franc terms for the 12 months ended 31 March 2021, and net assets surpassing CHF2bn for the first time. The fund has evolved from a pure private equity focus to a public-private hybrid, with a large proportion (67%) of its listed portfolio made up of companies that began in the private portfolio but have continued to be held post IPO. Although near-term market conditions for listed healthcare and biotech look more challenging as 'hot money' flows out of the sector, HBMN's science-led investment process and conservative valuation approach should help it build on its long-term record of success as it enters its third decade. A cash distribution of CHF9.50 (+23.4% y-o-y) is supplemented by a special CHF3.00 anniversary payout to reflect the strong FY21.

Strong long-term outperformance for HBMN's investors



Source: Refinitiv, Edison Investment Research. Note: Total returns in Swiss francs.

Why invest in healthcare now?

The healthcare and biotech sectors are underpinned by positive fundamentals as medical advances and an increase in life expectancy drive demand for more and better treatments globally. The rapid development of effective COVID-19 vaccines has shone a light on the increased capability of the sector to innovate and provide solutions. Meanwhile, a near-term correction in share prices, as investors rotate towards more cyclical and value areas in the expectation of economic reopening, means a potentially attractive entry point for long-term investors.

The analyst's view

While HBMN has progressed particularly rapidly in the past year, we would argue that the seeds of its success lie in a consistent approach to backing quality companies, sometimes over the very long term (Cathay Biotech, a 2020 IPO and currently the largest investment, had been in the private portfolio since 2006), as well as constantly refreshing the portfolio with new private investments. Although healthcare investing can go in and out of favour with generalist investors, leading to some volatility of returns, we believe HBMN's approach is sustainable and now more widely appreciated (borne out by a 12-month average premium to NAV of 5.0%) and we do not see a return to the deep discount it has seen in the past.

Price		**CHF348.50**
Market cap		**CHF2,425.6m**
AUM		**CHF2,147.1m**

NAV*		CHF308.49
Premium to NAV		13.0%

*Including income. As at 31 May 2021.

Prospective yield		2.7%
Ordinary shares in issue		6.96m
Code/ISIN		HBMN/CH0012627250
Primary exchange		SIX
AIC sector		N/A
52-week high/low	CHF351.00	CHF226.45
NAV* high/low	CHF309.25	CHF233.16

*Including income

Gross gearing*	5.0%
Net cash*	10.0%

*As at 31 March 2021

Fund objective

HBM Healthcare Investments (formerly 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 diagnostic sectors, and related areas. It invests worldwide, predominantly in later-stage private companies (either directly or through funds) and publicly listed holdings, many of which began as private equity investments.

Bull points

- Fundamentals for healthcare industry and innovation remain strong.
- HBMN has a 20-year record of successfully backing earlier-stage companies.
- Cautious valuation approach and c 4% yield provide some stability in volatile markets.

Bear points

- Recent correction in highly valued biotech names could persist as generalist investors retrench.
- Earlier-stage or single-product companies have a higher risk of clinical failure.
- Ever-present threat of greater US government pressure on drug pricing.

Analysts

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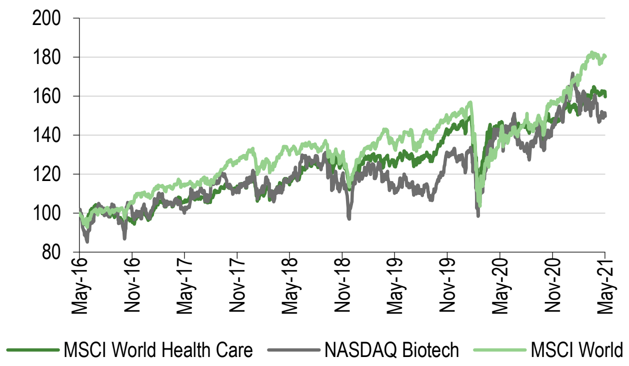
Market outlook: Valuations looking more favourable

As shown in Exhibit 1 (left-hand chart), healthcare and biotechnology equities have produced strong returns over the past five years, although they have suffered versus the broad market in the recent rotation towards more cyclical and value areas as investors begin to focus on life after lockdowns and the beneficiaries of economic reopening. This has led to forward P/E valuations that in the case of pharmaceutical companies are lower than those of the broad global index, and for both pharma and biotech are close to long-term averages, whereas the forward P/E for the Datastream World index is 28% higher than the average over 10 years (Exhibit 1, right-hand table).

However, while we face new realities as we move from pandemic to endemic COVID-19 and deal with the inevitable consequences of missed and late diagnoses due to the effect of lockdowns, the fundamentals underpinning healthcare investment remain largely unchanged: a large and ageing global population, a favourable regulatory environment, greater scientific understanding driving new innovations in treatment and an increasingly affluent middle class in the developing world keen to enjoy a better standard of healthcare. Given this outlook, a fund focused on supporting and reaping the benefits of healthcare innovation could stand investors in good stead over the longer term, and having an element invested in private companies at stable valuations could help ride out any near-term equity market volatility.

Exhibit 1: Performance and valuation of healthcare, biotech and global equities

Performance of healthcare, biotech and global equities over five years (CHF)



Valuation metrics of Datastream indices (at 28 May 2021)

	Last	High	Low	10-year average	Last as % of average
Word – Pharma	14.8	18.8	10.2	15.0	99
World – Biotech	31.8	41.0	22.6	29.9	106
World	18.5	19.8	10.0	14.4	128

Source: Refinitiv, Edison Investment Research

The fund manager: HBM Partners

The manager's view: Fundamentals remain solid

HBMN's CEO, Andreas Wicki, says that while the recent market rotation makes it clear that 'the easy money in technology and biotechnology has been made', he remains confident in the fundamentals of the earlier-stage healthcare companies in which the fund invests. 'With looming inflation and the economy booming, there is clearly a trend towards more cyclical areas and a sell-off in the most hyped-up tech and biotech stocks,' he comments. 'We see it as healthy that there has been a correction in these inflated valuations. However, there has not been a lot of poor clinical news – there are few disappointments on the fundamental science.'

Reflecting on the near-term prospects for the fund after its record returns in FY21, CFO Erwin Troxler says: 'Last year was exceptional due to the high number of IPOs, and we did make some small crossover investments in IPO candidates that seemed to be very promising, but as usual we are clearly focused on the science and going forward we will be quite cautious and selective. We still plan to do approximately CHF100m of new private investments in the coming year, but we will go step by step as we see how the public market develops.' He explains that in more volatile equity market conditions, it would not be prudent to over-commit on the private side and risk having follow-on commitments that would necessitate the sale of public investments at depressed valuations, although retaining a good weighting in private equity is usually positive for the fund in a falling equity market because of the cautious valuation approach (see Investment process). Wicki adds: 'The lesson from 2010–13 is that if a correction goes deeper, private investments get cheaper, so you don't want to deplete the public companies as they will see the rebound first.'

The outlook for the sector – especially after COVID-19 – remains very positive over the medium term, in the managers' view. 'We are seeing big scientific progress with new markets to identify specific patient populations,' says Troxler. 'Over the next 12 to 18 months there will be market swings given inflation fears and the risks of high equity market valuations, and we don't know how much generalist investors will sell and at what prices, but regardless of that, our portfolio is well diversified, carefully assembled and well balanced. We are invested in a high degree of quality companies with great positions in their fields, we have a solid pipeline of promising new investments with some near-term closures, and we anticipate that we will create future value for our shareholders in the next three to five years.'

Wicki adds that while equity markets are jittery and many companies' share prices have corrected strongly, HBMN's NAV per share is broadly flat year-to-date and the shares are still trading at a premium to NAV. 'In this sort of market environment historically, we would have been trading at a discount, but the current rating and the fact we have performed well, including a 4% average dividend yield over many years shows we have a stronger hand than in the past – people want to be associated with the business in the medium to long term.'

Asset allocation

Current portfolio positioning

Although more than 40% of HBMN's portfolio is held in its 10 largest investments (Exhibit 2), the portfolio is broadly diversified, with a total of more than 100 named investments (40 private, 17 funds, 17 ex-private and 33 listed) at end-March 2021, along with a further CHF59m (c 3% of NAV) in unidentified small positions across the private, funds and listed categories.

Exhibit 2: Top 10 holdings (at 31 March 2021)

			Portfolio weight %	
Company	**Country**	**Clinical focus**	**31 March 2021**	**31 March 2020***
Cathay Biotech**	China	Industrial polymers	14.1	10.5
Harmony Biosciences**	US	Narcolepsy/cataplexy	7.0	3.0
BioAtla**	US	Oncology	4.0	N/A
ALX Oncology**	US	Oncology	3.2	0.2
Swixx Biopharma***	Switzerland	Distribution	2.8	2.1
Y-mAbs**	Denmark	Cancer immunotherapy	2.7	3.5
Neurelis***	US	Epilepsy	2.6	1.8
Instil Bio**	US	Oncology	2.5	N/A
HBM Genomics	N/A	Genomics fund	2.2	0.9
6 Dimensions Capital	N/A	China-focused fund	2.1	1.1
Top 10 (% of holdings)			**43.3**	**47.2**

Source: HBM Healthcare Investments, Edison Investment Research. Note: *N/A where not in end-March 2020 portfolio. **Originally held in private portfolio. ***Private company. Swixx valuation does not account for the capital increase announced on 28 May 2021.

Six of the top 10 holdings are ex-private positions, with five of them (Y-mAbs is the exception) having gone public during FY21. This helps to explain the big shift in asset allocation during the year (Exhibits 3 and 4); while the purely listed portfolio remained stable at c 20%, the ex-private portion rose from 19% to 39% over the 12 months, with the private portfolio falling from 35% to 20% of the total. Taking both private and ex-private holdings together, the change is only +5pp over the period (from 54% to 59%), largely accounted for by a 4pp reduction in cash and equivalents.

Among the private investments, Central and Eastern Europe-focused distribution specialist Swixx Biopharma could move up the rankings after the announcement on 28 May of a €45m capital increase, in which HBMN invested a further €5m alongside €40m from Mérieux Equity Partners. This resulted in a 67% valuation uplift for the company, which would have the effect of increasing its percentage weight in the HBMN portfolio to c 4.6% from 2.8% at end-March.

Exhibit 3: Asset allocation at 31 March 2021

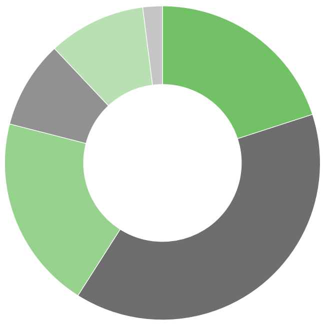
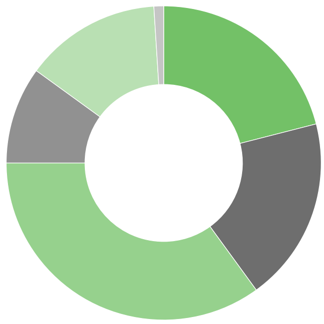


Exhibit 4: Asset allocation at 31 March 2020



Source: HBM Healthcare Investments, Edison Investment Research.

Compared with the MSCI World Health Care index, of which c 71% is listed in the US, with a further c 20% split between Switzerland, Japan, the UK and Denmark, HBMN's portfolio is much more geographically diverse (Exhibit 5), most notably with 29% in Asia (including a significant amount in China, which is not included in the index). In recent years, HBMN has hedged part of its listed equity exposure via short positions in the S&P Biotech index ETF (XBI), although the hedges were reduced throughout FY21 and as at end-April 2021, the market exposure was unhedged, although c 50% of the US dollar exposure remains hedged into Swiss francs (see footnote to Exhibit 6).

Exhibit 5: Portfolio breakdown by geography

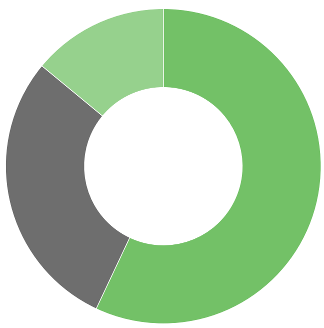
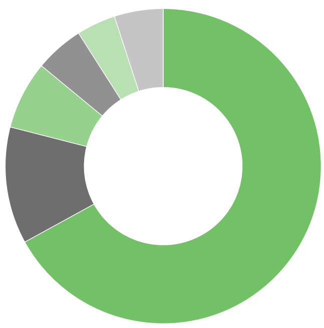


Exhibit 6: Portfolio breakdown by currency*



Source: HBM Healthcare Investments, Edison Investment Research. Note: Data at 31 March 2021. Note: *Including hedges, USD exposure is 31% and CHF exposure is 41%.

The managers were highly active in making new investments during FY21, with 24 new private investments added during the period (several of which, including BioAlta, Connect Bio and Werewolf Therapeutics, have now listed on the stock market). Looking at a few of the larger purchases, Troxler says the team invested CHF20m in the third quarter of the financial year in Ambrx, a US company with a late-stage oncology platform and Chinese management/founders). 'It is an IPO candidate later this year and could be an interesting opportunity,' he adds. Valo Health (also Q3) was a CHF15m investment – 'they have an integrated drug development platform using AI, and could also get some traction if they do an IPO as planned'. In the last quarter of the financial year the team invested in IO Biotech, a Danish oncology name, with a commitment of CHF20m that will be called in tranches (CHF8m already drawn). In the summer of 2020, CHF5m was invested in Monte Rosa Therapeutics, an early-stage company with a preclinical protein degradation platform that Troxler describes as promising. It is also an IPO candidate and HBMN recently invested a further CHF9m in second round of financing. 'We would expect it to be a typical crossover investment,' the CFO says, referring to the late-stage private/pre-IPO investments that have characterised much of the fund's deal flow in recent years.

Exhibit 7: Portfolio exposure by clinical focus (% unless stated)

	Portfolio end-March 2021	Portfolio end-March 2020	Change (pp)
Oncology	28.0	19.0	9.0
CNS disorders	17.0	13.0	4.0
Immunology/inflammation	8.0	12.0	(4.0)
Orphan diseases	6.0	12.0	(6.0)
Medtech/diagnostics	5.0	5.0	-
Digital health	4.0	4.0	-
Renal/metabolic diseases	2.0	3.0	(1.0)
Infectious diseases	2.0	2.0	-
Others	28.0	30.0	(2.0)
	100.0	**100.0**	

Source: HBM Healthcare Investments, Edison Investment Research

The high pace of recent activity has resulted in some shifts in the portfolio in terms of clinical focus and development stage (Exhibits 7 and 8), with a higher proportion involved in oncology and central nervous system disorders (+9pp and +4pp respectively). There has been a significant increase in the number of companies whose most advanced clinical stage is Phase I (+13pp), with a similarly sized decrease in those at Phase III (-16pp). However, it is important to note there remains a focus on companies with products that have successfully launched and are generating revenues, with 50% of the portfolio (from 51% at end-FY20) invested in these areas.

Exhibit 8: Portfolio exposure by clinical development stage* (% unless stated)

	Portfolio end-March 2021	Portfolio end-March 2020	Change (pp)
Profitable	21.0	25.0	-4.0
Products on the market	29.0	26.0	3.0
Phase III	12.0	28.0	-16.0
Phase II	18.0	17.0	1.0
Phase I	16.0	3.0	13.0
Pre-clinical	4.0	1.0	3.0
	100.0	**100.0**	

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

Performance: Record returns in FY21

Exhibit 9: Five-year discrete performance data

12 months ending	Share price (%)	NAV (%)	MSCI World Health Care (%)	NASDAQ Biotech (%)	CBOE UK All Companies (%)
31/05/17	22.6	1.3	5.4	0.0	7.4
31/05/18	51.1	26.7	8.6	16.3	11.7
31/05/19	13.9	17.7	8.2	(5.3)	(6.4)
31/05/20	40.2	22.2	18.3	29.5	(17.6)
31/05/21	47.3	36.0	10.9	6.1	32.8

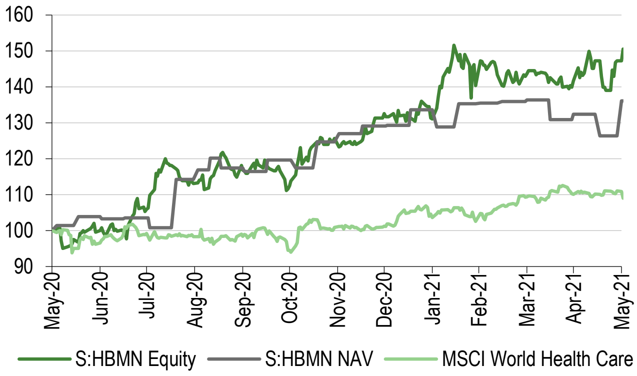
Source: Refinitiv, HBM Healthcare Investments. Note: All % on a total return basis in Swiss francs.

In FY21 (ended 31 March), HBMN generated an NAV total return of 52% and a share price total return of 79%. As shown in Exhibit 9, the figures over 12 months to 31 May are somewhat lower but still impressive at 36.0% and 47.3%, respectively. The difference is partly down to the base effect of starting from 31 May 2020 (by which time the recovery from the COVID-19 equity market shock was well established) rather than 31 March and reflects a more difficult period for healthcare stocks in April 2021. As seen in Exhibit 10, the fund's NAV return over the past one and three months has been flat to slightly positive. However, the annualised NAV returns of c 20% pa or more over three, five and 10 years validate the managers' long-term return expectation of c 10–15% pa even taking account of the outsize returns in FY21.

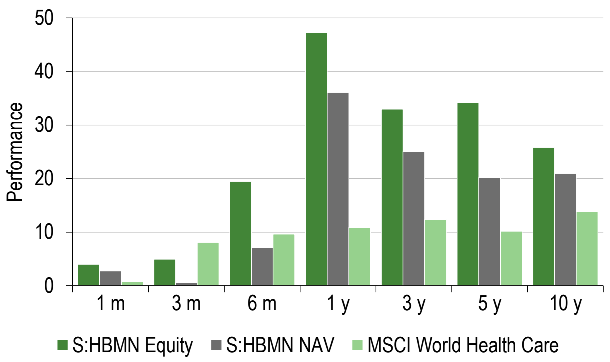
Troxler says the main contributor to performance in the financial year was IPOs and trade sales from the private equity portfolio. There were a total of 12 IPOs and six trade sales from the unlisted portfolio (including Viela Bio, which debuted on the NASDAQ exchange in October 2019 and was acquired by Horizon Therapeutics in January 2021), leading to a contribution of CHF662m from private companies (including ex-private). As well as the uplift from IPOs (including post-IPO share price performance), this figure includes positive value adjustments based on financing rounds and some write-downs based on missed clinical data (a net adjustment of CHF45m including CHF16m of write-downs). There was also a good contribution from pure public investments of CHF276m, arising from the $21bn takeover of Immunomedics by Gilead Sciences (CHF68m contribution) and upward price moves at stocks such as Argenx, Rocket Pharmaceuticals and Biohaven (CHF80m contribution in aggregate) as a result of market sentiment supported by clinical data. The funds portfolio grew by CHF49m, boosted by the IPO of Seer (held by the HBM Genomics Fund as well as directly in the HBMN portfolio) as well as a number of IPOs from China-focused 6 Dimensions Capital, which also benefited from the takeover of Viela Bio. Market and currency hedges were a drag on performance (detracting by CHF57m and CHF12m respectively) given a weakening US dollar and a strong recovery in share prices during the financial year.

Exhibit 10: Investment trust performance to 31 May 2021

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



Price, NAV and benchmark total return performance (%)



Source: Refinitiv, Edison Investment Research. Note: Three, five and 10-year performance figures annualised.

Exhibit 11: Performance of last five IPOs from HBMN's private portfolio

Company	IPO date	US$m invested*	Performance from IPO to end-FY21 (31 March)	Performance from IPO to 1 June 2021
Werewolf Therapeutics	01-Apr-21	7.4	N/A	-13.7%
Instil Bio	19-Mar-21	18.5	25.4%	-14.0%
Connect BioPharma	19-Mar-21	15.1	8.8%	-15.2%
Longboard Pharmaceuticals	12-Mar-21	18	2.4%	-46.4%
BioAtla	16-Dec-20	29.1	182.4%	134.1%

Source: HBM Healthcare Investments, Edison Investment Research. Note: *Includes money invested privately and at IPO. **Includes investment via HBM Genomics fund.

In Exhibit 11, we illustrate the performance of the last six IPOs from HBMN's private portfolio. While all had performed positively between IPO and the end of the fund's financial year (with the exception of Werewolf Therapeutics, which listed after HBMN's FY21 year-end), the impact of less favourable market conditions in April and May is clear, with the four most recently listed companies having fallen well below their IPO price at 1 June. However, BioAtla – HBMN's largest recent IPO, with $29.1m invested – is still up more than 100% since its NASDAQ debut in December 2020.

Looking at relative performance (Exhibits 12 and 13), HBMN has markedly outperformed both the MSCI World Health Care index (its official comparator) and the NASDAQ Biotechnology index over most periods shown. Performance since the beginning of the market rotation towards more value and cyclical companies (sparked by positive news on COVID-19 vaccines leading to an expectation of economic recovery) has been more mixed, as areas away from the cutting edge of technology have tended to perform better in recent months. We have included a comparison with a broad UK equity index given its likely relevance to readers; the UK has benefited more than most markets in the rotation (boosted by the agreement of a trade deal with the EU in December 2020), given it had been badly out of favour with international investors since the Brexit vote in 2016.

Exhibit 12: Share price and NAV total return performance (in CHF terms), relative to indices (%)

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to MSCI World Health Care	3.3	(2.9)	9.0	32.8	65.7	168.2	171.1
NAV relative to MSCI World Health Care	2.1	(6.9)	(2.2)	22.7	37.9	54.7	82.9
Price relative to NASDAQ Biotech	7.5	9.2	14.5	38.7	80.6	187.6	114.7
NAV relative to NASDAQ Biotech	6.3	4.7	2.7	28.2	50.3	65.9	44.8
Price relative to CBOE UK All Companies	1.3	(5.7)	(2.1)	10.9	129.6	254.6	487.6
NAV relative to CBOE UK All Companies	0.1	(9.6)	(12.2)	2.5	91.1	104.5	296.4

Source: Refinitiv, Edison Investment Research. Note: Data to end-May 2021. Geometric calculation.

Exhibit 13: NAV performance versus benchmark over three years

Source: Refinitiv, Edison Investment Research

Peer group comparison

Exhibit 14: Selected peer group as at 25 May 2021, in Swiss franc terms*

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Ongoing charge	Perf. fee	Premium/ (discount)	Net gearing	Dividend yield
HBM Healthcare Investments	**2,330.6**	**28.9**	**83.4**	**154.2**	**529.5**	**1.3**	**Yes**	**14.7**	**100**	**2.3**
BB Biotech	4,348.9	5.7	29.5	65.8	651.2	1.3	No	21.4	107	4.6
BB Healthcare	1,229.6	24.3	58.8	--	--	1.1	No	0.9	100	3.3
Biotech Growth Trust	700.0	13.3	63.7	77.9	509.7	1.1	Yes	0.7	105	0.0
International Biotechnology Trust	370.9	1.6	22.9	47.4	323.7	1.3	Yes	0.5	100	4.0
Polar Capital Glbl Healthcare	394.1	13.3	33.3	49.0	185.7	1.1	Yes	(10.6)	107	0.8
RTW Venture	386.0	60.7	--	--	--	2.1	Yes	11.1	100	0.0
Syncona	1,785.0	17.1	23.6	57.1	--	1.8	No	3.5	100	0.9
Worldwide Healthcare Trust	3,009.2	11.0	38.7	76.6	357.0	0.9	Yes	0.1	102	0.7
Simple average (9 funds)	**1,617.1**	**19.6**	**44.2**	**75.4**	**426.1**	**1.3**		**4.7**	**102**	**1.9**
HBMN rank in peer group	**3**	**2**	**1**	**1**	**2**	**4**		**2**	**5=**	**4**

Source: Morningstar, Edison Investment Research. Note: *Performance as at 24 May 2021 based on ex-par NAV. TR = total return. TER = total expense ratio. Net gearing is total assets less cash and equivalents as a percentage of net assets.

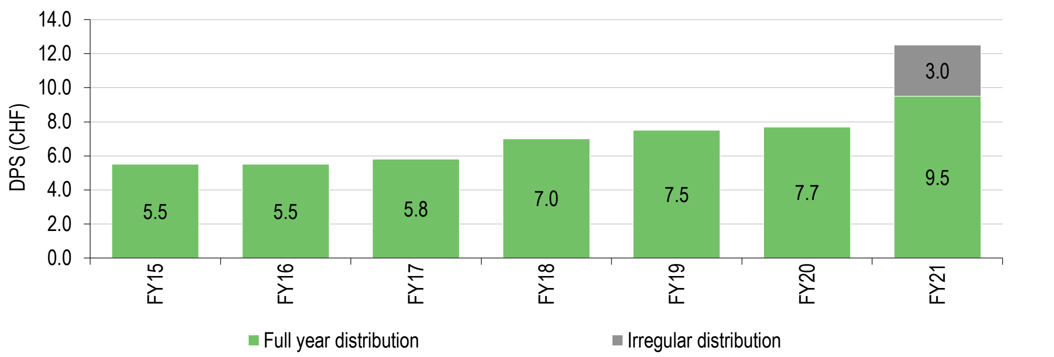
As a non-UK listed fund, HBMN is not part of the Association of Investment Companies' Biotech & Healthcare sector. However, as this is the most appropriate peer group for comparison, in Exhibit 14 we present HBMN (along with fellow Swiss fund BB Biotech) in the context of the AIC sector. Although all the peers share a focus on healthcare and/or biotechnology, each takes a slightly different approach. Several of the funds have some exposure to private equity; in fact, based on the latest available data, only three of the nine funds shown (BB Biotech, BB Healthcare and Polar Capital Global Healthcare) have no exposure to unlisted investments. Of the others, stablemates Biotech Growth Trust and Worldwide Healthcare Trust are each limited to 10% in unlisted companies (currently 7.3% and 5.7% exposure respectively), mainly or wholly in 'crossover' investments (that is, private investments usually made in the last funding round before IPO). International Biotechnology Trust is managed by a private equity-focused investment house, SV

Life Sciences, but predominantly invests in quoted companies, with 10% currently held in private equity (6% in SV Fund VI and 4% directly). Syncona originally had a fund of funds structure, but now focuses on founding and building biotech and healthcare companies, with c 23.7% of its assets currently in unlisted assets (55% of its NAV, or the whole of its investment portfolio, is in private or ex-private holdings, with 45% in cash or near-cash to fund investment opportunities). RTW Venture has the most similar profile to HBMN, with 23% of its portfolio in unlisted stocks but 65% in private and ex-private (compared with 20% and 59% respectively for HBMN). However, RTW Venture is a relatively new entrant, having been launched in October 2019, making it hard to draw meaningful comparisons given the lack of a track record.

HBMN ranks comfortably top in the group for NAV performance (in Swiss franc terms) over three and five years, and second over one and 10 years. Broadly speaking, the funds that have performed better over the past 12 months are those with a focus on multiple areas of healthcare rather than those specialising in biotechnology, which have been more affected by the market rotation out of technology and biotech over recent months. HBMN trades at the second highest premium to NAV (only BB Biotech's is higher), with all the peers bar one currently also trading at a premium. Ongoing charges are average and HBMN's 2.3% dividend yield (based on the FY20 distribution and the 25 May share price) is above average, ranking fourth. Using the FY21 ordinary distribution of CHF9.50, the yield would rise to 2.8% but would still rank fourth. It is worth noting that all the funds with an above-average yield have a policy of paying out a proportion of NAV annually (generally between 3% and 5%) as a cash distribution. HBMN is one of six funds in the group that may pay a performance fee, and one of five peers to have an ungeared of net cash position.

Dividends: Stellar year leads to bumper distribution

Exhibit 15: Distribution history since FY15



Source: HBM Healthcare Investments, Edison Investment Research

While companies in the earlier-stage healthcare and biotech space tend to be more focused on R&D spending than paying dividends to investors, HBMN has long recognised the attractiveness to its shareholders of a regular income in an environment of persistently low yields on cash and bonds. With this in mind, since 2013 it has followed a policy of paying out 3–5% of NAV each year as a cash distribution, with the ambition of providing a stable to rising payout each year (CAGR of 7.0% a year from FY15 to FY20). Given the record NAV performance in FY21, the board has chosen to split the FY21 distribution into a base distribution of CHF9.50 (3.1% of the CHF309.25 year-end NAV and a 23.4% increase on the CHF7.70 paid in respect of FY20) and a special 'anniversary' payment of CHF3.00, keeping the overall distribution yield at c 4% without providing an insurmountable hurdle for maintaining or growing the distribution in future years. As in recent years, the distribution will be paid in September and treated as a reduction in the par value of the shares, which is more tax efficient for HBMN than transferring part of the par value into capital reserves and then paying it out. Troxler says of the distribution policy: ‘It keeps us disciplined as it forces us to take profits to generate cash to reward the shareholders, and the shareholders like it too.’

Discount: Sustained rerating to a consistent premium

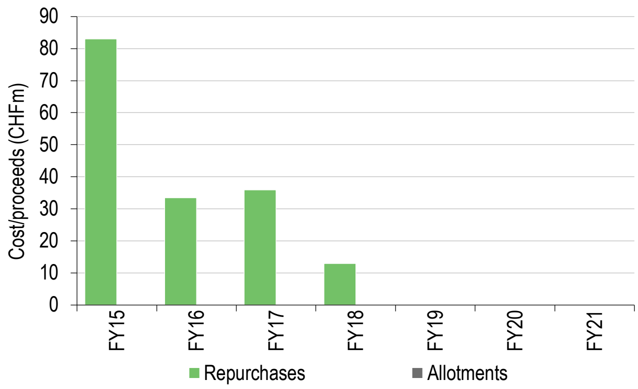
HBMN’s shares have gradually rerated over the past five years from a long-term discount to NAV of c 20–30% (averaging 20.5% over 10 years) to around par or a small premium in 2019. While this trend was disrupted during the COVID-19-related global equity market sell-off in Q120, with the share price falling to a three-year widest discount of 25.9% in March, the rerating resumed through the remainder of 2020 and has continued into 2021 against a backdrop of robust NAV performance. Although there have been a couple of spikes in the premium over the past nine months (reaching an all-time high of 21.5% in August 2020 and coming close to this level again in February 2021), Exhibit 16 shows the sustained progress in the rating since April 2020, with the premium to NAV standing at 13.0% at 1 June 2021, compared with a 12-month average premium of 5.0%. We would argue the large number of successful IPOs from HBMN’s private portfolio over the past three years has been a significant factor in the rerating, providing proof of the managers’ ability to identify and back promising healthcare companies at an early stage of their development. While the premium to NAV could fade a little from its current double-digit level given more difficult equity market conditions and a shift in investor sentiment towards the healthcare sector, we do not see a return to a sustained or significant discount to NAV in the near term.

Following the completion of the 2016 share buyback programme, a new programme was launched in June 2019, under which up to 696,000 shares (10.0%) may be repurchased in the three years to 27 June 2022. So far, the facility has not been used (Exhibit 17).

Exhibit 16: Discount/premium over three years

Source: Refinitiv, Edison Investment Research

Exhibit 17: Buybacks and issuance



Source: Morningstar, Edison Investment Research

Fund profile: A 20-year record of healthcare innovation

Beginning its life in 2001 as HBM BioVentures, HBMN is a Switzerland-based healthcare investment company that has been listed on the SIX Swiss Exchange since 2008. It has evolved from a pure private equity investor focused on the biopharmaceutical sector, into a globally diversified portfolio of listed and private healthcare companies and private equity funds. Many of the listed holdings were originally private investments that HBMN’s management continued to back following their stock market debuts. While its main aim is to achieve long-term capital growth for its investors, the fund also offers a high distribution policy, paying out c 3–5% of NAV each year.

HBMN measures its performance with reference to the MSCI World Health Care Index (in Swiss franc terms). However, given the significant proportion in unlisted holdings and the lack of exposure to ‘big pharma’, investors should be prepared for the fund’s performance to differ materially from that of the index. In particular, its conservative approach to valuing private investments should limit the volatility of returns, although it should be noted some of these companies may be earlier stage and therefore at higher risk of disappointing clinical outcomes.

The fund publishes fortnightly NAVs, monthly summary factsheets and full portfolio valuations are available quarterly. It is overseen by a non-executive board (mainly made up of pharmaceutical industry specialists), with the fund management team being led by chief executive officer Andreas Wicki and chief financial officer Erwin Troxler.

Investment process: Focus on science and opportunity

While it has its roots in private equity investment, HBMN now invests across the spectrum of smaller listed (usually sub-$2bn market cap) and unlisted companies in the healthcare and biotechnology sectors, as well as in private equity funds. The team focuses on companies with innovative platforms and drug candidates. With a significant proportion of the listed companies (67.2% at 31 March 2021) having started out in the unlisted portfolio, the fund manager has recently begun reporting its listed investments in two segments (those originating as private holdings, and those bought as public companies). HBM Partners has teams specialising in private and listed equity and the teams meet with each other weekly to discuss clinical and market developments. Most of the investment team members have a life sciences background.

HBMN follows a bottom-up approach, selecting stocks from an investment universe of c 1,000 companies to build a diversified portfolio of c 60–100 investments with solid long-term growth potential. To generate investment ideas, the teams track clinical trends, attend industry conferences and communicate with a network of industry experts and executives. They then analyse potential investments both quantitatively and qualitatively, assessing the companies’ intellectual property and stakeholder involvement and write up a summary of the opportunity, which may include a recommendation to invest.

On the private equity side, the team sources deals through its own networks, as well as via investment banks, other venture capital investors and directly, aiming typically to make eight to 12 deals each year (FY21 was exceptional, with 24 new private investments). HBMN seeks to be an active lead or co-lead investor, sharing entrepreneurial responsibility with a firm’s management team, and securing board representation. A clear expectation of an exit, usually either through an initial public offering (IPO) or trade sale, is inherent in all private investments. In recent times many of HBMN’s new private positions have been taken specifically as pre-IPO ‘crossover’ investments, with the expectation of flotation in a matter of months, although some private holdings have been in the portfolio for a number of years.

The private portfolio is characterised by a conservative approach to valuation, with most positions held at acquisition cost. They may be revalued up or down when a financing round with a third-party lead investor establishes a new ‘price’, and will be written down in steps of 25%, 50%, 75% or 100% in response to negative clinical or regulatory developments. Positive developments are reflected only at the point of a liquidity event, such as a third-party financing round, IPO or trade sale. The exception is where a private company has significant revenues and profits, in which case it will be valued based on appropriate sales or earnings multiples. In the listed portfolio, valuations are based on market prices and reflect positive or negative sentiment and/or developments as they occur.

HBMN’s managers seek to build a portfolio that is diversified by geography, clinical focus and development stage. The private equity funds portfolio has a tilt towards emerging markets, where it may be harder for the team to assess individual private opportunities. The overriding aim is to generate long-term capital growth, although there is also a focus on downside protection and the managers may use hedges in the public portfolio (currently unhedged). Positions are continually reviewed and risk management also includes ongoing monitoring of global markets and macroeconomic developments.

HBMN's approach to environmental, social and governance

While there is no official statement specifically detailing HBMN's approach to environmental, social and governance issues, it is clear that any investment strategy targeting companies that are developing innovative solutions to intractable medical problems is helping to provide a social benefit as new treatments come to fruition. On the governance side, a thorough assessment of the quality of management is fundamental to HBM Partners' investment process, and as an active investor in earlier-stage and private companies, HBMN helps contribute to the performance of its holdings though board representation by its investment consultants at numerous portfolio companies.

Gearing: Modestly geared with healthy cash balance

HBMN is geared via two bond tranches of CHF50m each (equating to c 5.0% of net assets at 24 May 2021), maturing in July 2021 and July 2023. However, at 30 April 2021, the gearing (and the cost of market hedges) was more than offset by cash and equivalents and HBMN had a net cash position of 10.0% (CHF226m). So far there has been no indication as to whether the board plans to replace or refinance the maturing bond issue.

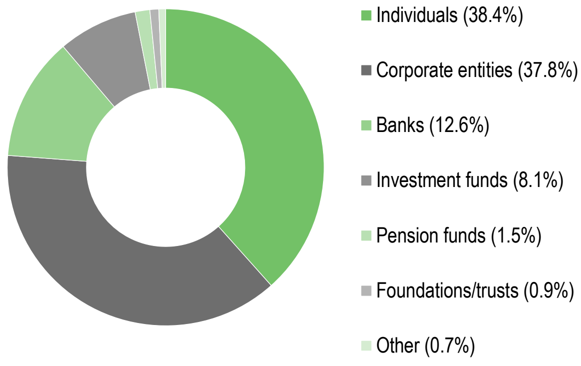
Fees and charges

HBM Partners is paid an annual management fee of 0.75% of HBMN's NAV plus 0.75% of its market cap, calculated and paid quarterly. Based on four quarter-ends of FY21 (to 31 March 2021), we calculate ongoing charges at 1.29% (FY20: 1.34%). A performance fee may also be paid if the year-end NAV per share (before accounting for any performance fee) is more than 5% above the high-water mark (the year-end NAV at which a performance fee was last paid). The fee earned is equal to 15% of the excess performance above the 5% hurdle. A performance fee of CHF24.7m (1.7% of net assets) was paid in respect of FY20, when the pre-performance fee NAV per share at the year-end (which formed the new high-water mark) was CHF212.03. Given the particularly strong performance in FY21 (with the year-end NAV standing at CHF309.25, or 45.9% above the high-water mark), the performance fee earned by HBM Partners for the year just ended is substantial at CHF120.7m (5.6% of net assets), with a further CHF8.0m in variable compensation paid to the board. The new high-water mark is CHF327.77, which is likely to prove a challenging target given the more uncertain market conditions that currently prevail.

Capital structure

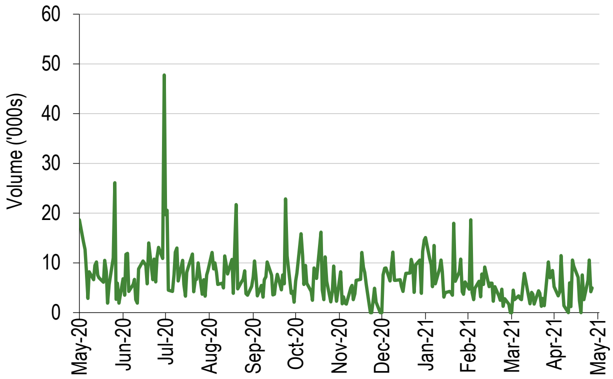
Structured as a closed-ended investment company, HBMN is listed on the SIX Swiss Exchange and has one class of share, with 7.0m ordinary shares in issue. As shown in Exhibit 18, the fund has quite a diverse shareholder base, with only one entity (Nogra Pharma Invest, which holds c 15% of the shares) having an interest of more than 3%. Exhibit 19 shows an average daily traded volume of 7,100 shares (0.10% of the share base) over the 12 months to 24 May 2021, which is a reasonable level of liquidity compared with a more mainstream fund such as The Biotech Growth Trust (0.25% daily traded volume).

Exhibit 18: Major shareholders



Source: HBMN, at 31 May 2021.

Exhibit 19: Average daily volume



Source: Refinitiv. Note 12 months to 1 June 2021.

The board

Exhibit 20: HBM Healthcare Investments' board of directors

Board member	Date of appointment	Remuneration in FY21 (CHF)*	Shareholdings at end-FY21
Hans Peter Hasler (chairman)	2009	110,000 + 1.29m	7,710 (-790)
Prof Dr Heinz E Riesenhuber (vice-ch)**	2001	85,000 + 1.29m	4,534 (+534)
Dr Eduard E Holdener**	2008	40,000 + 1.29m	663 (-737)
Robert A Ingram**	2006	50,000 + 1.29m	1,534 (+534)
Dr Rudolf Lanz	2003	70,000 + 1.29m	2,365 (-935)
Mario G Giuliani	2012	50,000 + 1.29m	1,100,612**** (+877)
Dr Stella X Xu	2020	40,000 + 425k	0 (0)
Dr Elaine V Jones***	2021	N/A	N/A

Source: HBM Healthcare Investments. Notes: *Board fees are made up of a fixed fees (a base fee of CHF94,000 for the chairman, 43,000 for the vice-chairman and 28,000 for the other directors, plus fees for meetings and committee attendance), plus a variable amount based on the fund's performance. The variable fees are funded out of the performance fee received by the manager. **Retiring at June 2021 AGM. ***With effect from June 2021 AGM. ****Shares are held by Nogra Pharma Invest, in which Mario G Giuliani has a beneficial interest.

On 7 May 2021, HBMN announced that three of its long-serving directors were to retire at the forthcoming AGM in June. At the same time, the appointment of Dr Elaine Jones was announced. Dr Jones has more than 20 years' experience in venture capital financing for bioscience companies, including over 10 years spent as vice-president at Pfizer Ventures with responsibility for managing investments in biotechnology and healthcare companies. Dr Stella Xu was appointed to the HBMN board at the 2020 AGM. She has a PhD in immunology and spent more than 15 years with Roche in the US and China, including heading up the company's Innovation Centre in Shanghai with around 200 scientists, before joining life sciences venture fund Quan Capital in 2017. The appointment of two eminently qualified female directors brings HBMN into line with Switzerland's new gender diversity law on board representation, as well as refreshing the skills of the board. Following the June 2021 AGM, HBMN will have three male and two female directors, with an average tenure of eight years. Each director has specific responsibilities regarding the monitoring of HBMN's portfolio and the wider market environment. Focusing only on those directors who will be in post following the AGM, the chairman covers regulatory (FDA) approval and sector and marketing strategies; Mr Giuliani monitors management, production and audit; Dr Lanz (a lawyer and corporate financier) also covers audit, as well as finance and M&A transactions; and Dr Xu assesses research and development.

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