

BB Biotech AG

Performing biotech fund at a discount

Investment trusts

BB Biotech AG (BION) is a Switzerland-based investment company investing in mid- to large-cap biotech companies. Its strong performance has continued during the last 12 months (BION's share price and NAV are c 16% and c 29% ahead of the benchmark NASDAQ Biotechnology Index respectively). The managers believe that new products being developed by portfolio companies could drive an acceleration of their average earnings, and M&A could enhance returns. BION's significant discount and capital distribution policy (5% cash distribution, up to 5% buybacks per year) also merit attention (see page 7).

12 months ending	Total share price return* (%)	Total NAV return* (%)	Total return NASBIOT Index* (%)	Total return MSCI World HealthCare* (%)	Total return DS World Pharma & Biotech* (%)
31/12/10	(15.1)	(8.7)	3.9	(7.1)	(6.0)
31/12/11	5.5	(2.2)	12.4	10.5	10.8
31/12/12	42.7	42.8	29.5	15.9	15.7
31/12/13	65.8	76.7	61.3	33.2	32.9

Note: *Twelve-month rolling discrete performance, CHF terms.

Investment strategy: Profitable and late-stage biotech

BION aims to generate a total return of 15% pa, over the long term (three to five years plus), by investing in a focused portfolio (20-35 stocks) of global biotech companies. The managers look for companies whose products address areas of significant unmet medical need and are capable of generating above-average sales and profit growth. These tend to be either already profitable or have drugs in the late stages of development. A modest level of gearing (typically 5-8%) is used to enhance returns over the longer term. Natural turnover is relatively modest (15-20% a year).

Outlook: Sentiment improving, valuations rising

The healthcare and biotech sectors benefit from a favourable demographic backdrop with increasing demand from ageing populations, most noticeably in the western world, and growth in population and utilisation, particularly in emerging markets. Biotech has provided a strong performance during the last five years and has experienced a significant re-rating during the last two. Valuations multiples have expanded, potentially leaving the sector more open to a correction but, for those investors able to take a longer-term view, the manager believes valuations are attractive and large-cap biotech's current P/E premium over large-cap pharma is justified because of biotech's superior growth prospects.

Valuation: Comparable to long-term averages

BION's discount of 24.4% is broadly in line with its three-year average of 21.3% and its five-year average of 22.4%. BION's board has committed to return up to 10% of capital each year (5% capital distribution/ up to 5% share buy-backs). Given the strength of the portfolio performance both in absolute and relative terms, it is surprising that the discount has not already narrowed. BION's discount is appreciably above the average for its peer group of 14.1% (3.3% excluding BION).

8 January 2014

Price	CHF145
Market cap*	CHF1,483m
AUM	CHF2,086m
NAV**	CHF191.7
Discount to NAV	24.4%
Yield	3.1%

* Market cap based on an issued share capital of 11.85m shares less estimated 1.62m shares in treasury (see page 7).
**Including income, as at 7 January 2014.

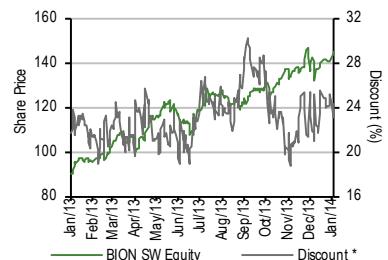
Ordinary shares in issue (inc. 1.62m estimated shares held in treasury) 11.85m

Code BION

Primary exchange Zurich

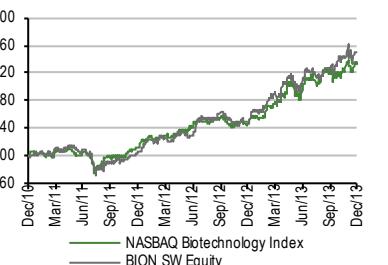
AIC sector SS: Biotech/Life Sciences

Share price/discount performance



*Positive values indicate a discount; negative values indicate a premium.

Three-year cumulative perf. graph



52-week high/low CHF146.9 CHF89.5

NAV* high/low CHF191.7 CHF114.6

*Includes income.

Gearing

Gross 6.1%

Net 5.0%

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[Edison profile page](#)

Exhibit 1: Trust at a glance
Investment objective and fund background

BB Biotech (BION) is a Swiss-domiciled investment company, targeting attractive long-term returns from predominantly mid-/large-cap biotech companies with established product portfolios (sales and earnings) and promising pipeline candidates. It is benchmarked against the NASDAQ Biotech Index, but is managed bottom-up with a concentrated 20-35 stock portfolio.

Recent developments

December 2013: Daniel Koller purchased 100 shares.
 November 2013: Erich Hunziker (chairman) purchased 25,251 shares.
 17 June 2013: 1.15m registered shares withdrawn from the commercial register (cancellation of treasury shares).

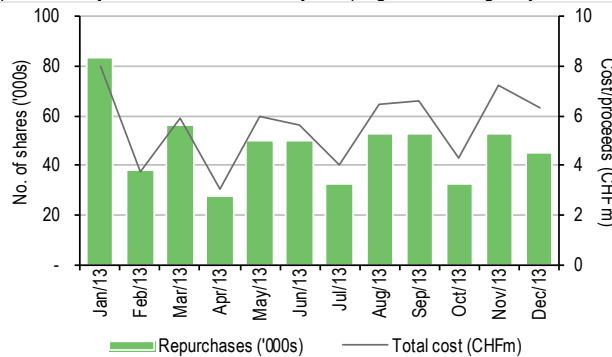
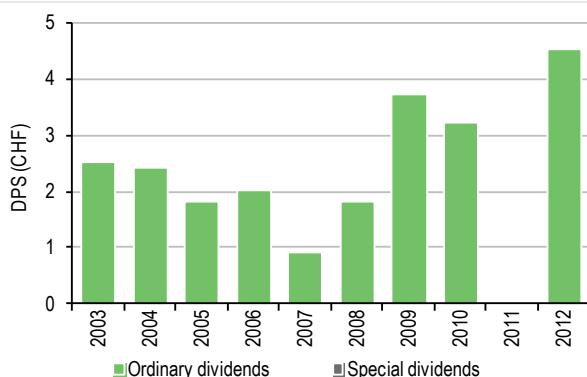
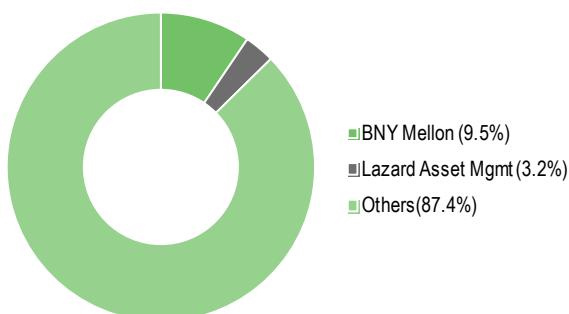
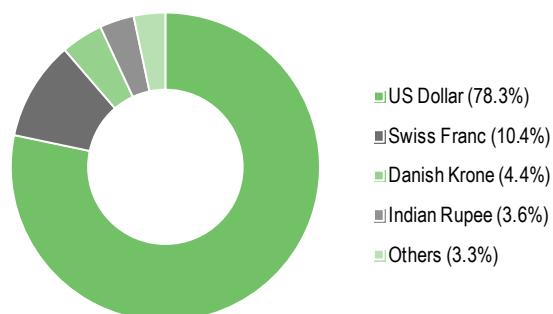
Forthcoming		Capital structure		Fund details	
AGM	March 2014	Ongoing charges	1.45%	Group	Bellevue Asset Management
Preliminary results	23 January 2014	Net gearing	5.0%	Manager	Team Managed
Year end	31 December	Annual mgmt fee	1.1% on market cap	Address	Seestrasse 16, 8700 Kusnacht, Switzerland
Dividend paid	March (part capital return)	Performance fee	None	Phone	+41 (0)44 267 6700
Launch date	November 1993	Trust life	Indefinite	Website	www.bbbiotech.com
Continuation Vote	None – see page 7	Loan facilities	See page 7		

Dividend policy and history

A new distribution policy was put in place from the year ended 31 December 2012 whereby BION makes a cash distribution equivalent to approximately 5% of its share price at the year end.

Share buyback policy and history

BION has authority, renewed annually, to repurchase up to 10% of its issued share capital. As part of the new distribution policy announced from the year ended 31 December 2012, BION has also committed to returning 5% of its share price, at the year-end, via the share buyback programme during the year.


Shareholder base (as at 31 December 2013)

Distribution of portfolio (as at 30 September 2013)

Top 10 holdings (as at 30 September 2013)

Company	Country	Sector	Portfolio weight %	
			30 September 2013	31 March 2013
Celgene	US	Biotech & Pharma/Biotech	13.0	14.3
Isis Pharmaceuticals	US	Biotech & Pharma/Biotech	11.4	5.7
Actelion	Switzerland	Biotech & Pharma/Specialty Pharma	10.4	13.1
Gilead	US	Biotech & Pharma/Biotech	9.6	10.1
Incyte	US	Biotech & Pharma/Biotech	7.7	5.8
Vertex Pharmaceuticals	US	Biotech & Pharma/Biotech	4.5	5.8
Alexion Pharmaceuticals	US	Biotech & Pharma/Biotech	3.7	N/A
Novo Nordisk	Denmark	Biotech & Pharma/Large Pharma	3.7	5.9
Medivation	US	Biotech & Pharma/Biotech	3.7	5.9
Ariad Pharmaceuticals	US	Biotech & Pharma/Biotech	2.9	3.4
Top 10			70.6	70.5
Cash			1.1	1.4

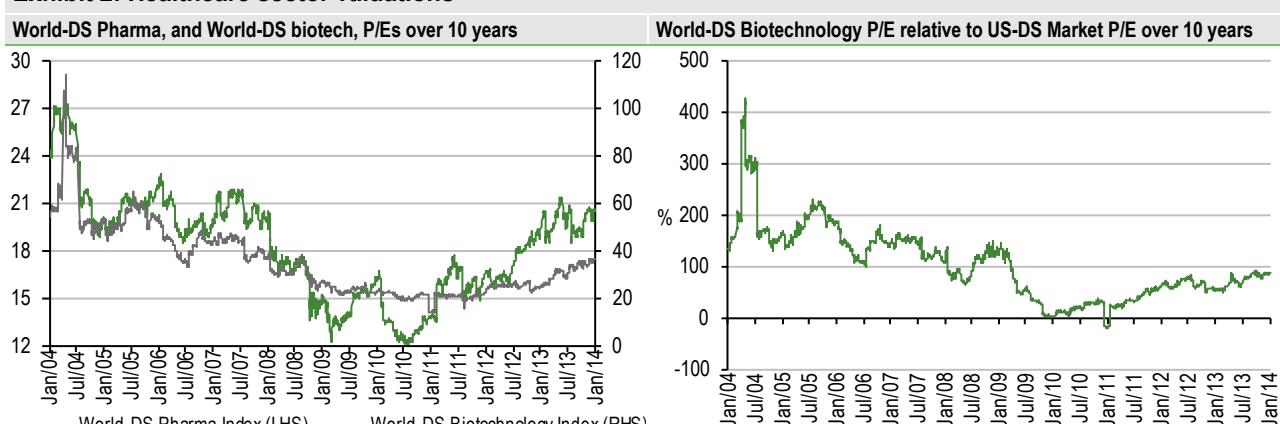
Source: BB Biotech AG, Edison Investment Research.

Outlook: Sentiment improving, Valuations rising

The healthcare and biotech sectors benefit from a favourable demographic backdrop with increasing demand from ageing populations, most noticeably in the western world, and growth in population and utilisation, particularly in emerging markets, where healthcare in general is typically a disproportionate beneficiary from growing income. Big pharma, at 55% of the MSCI Global Healthcare Index, is the largest subsector within the healthcare space. It has traditionally excelled at sales and marketing, but has frequently struggled to replace revenue as drugs have gone off-patent, despite spending large sums on R&D. Biotech companies, by comparison, have frequently been smaller, more focused and, in recent years, experienced stronger R&D success. This has seen an evolution whereby large-cap pharma and biotech companies have become increasingly reliant on externally sourced drugs. The rewards for discovering effective treatments are high but the associated risks also remain high. The high risk, as well as the need to understand the complex science that will often determine the success or failure of healthcare and biotech companies, remain strong arguments for investing via a portfolio managed by sector experts.

Biotech has provided a strong performance during the last five years (the NASBIOT is up 172% in CHF-adjusted total return terms), and during the last two years the sector has experienced a significant re-rating (up 109%). Price gains were initially matched by earnings increases, so valuations remained near historic lows, but valuation multiples have expanded during the last two years potentially leaving the sector more vulnerable to a correction (the P/E has risen from c 23x to c 37x). Our analysis shows there have been five significant corrections during the past five years, which on average have seen the NASBIOT fall 17%. However, in each case the sector has recovered. Recent performance has led to talk of a biotech bubble. As illustrated in Exhibit 2, biotech P/E ratios traded at a premium to the total US market from 2003 to 2009, albeit on a declining trend. Having reached parity in 2009, the trend has been an expanding premium to the market since, but the premium remains below its 10-year average. Current healthcare and biotech P/Es (36.8x for the World-DS Biotech Index and 14.8x for the World-DS Pharma index) are broadly in line with the longer-term 10-year averages (35.5x and 13.5x). Biotech's progress from here is likely to depend upon its ability to match or surpass estimated earnings growth, something the favourable secular drivers outlined above could support.

Exhibit 2: Healthcare sector valuations



Source: Thomson Datastream

Fund profile: Profitable and late-stage biotech

Founded in 1993, BION is a Swiss-domiciled investment company, which is listed in Zurich, Frankfurt and Milan. It invests in profitable and late-stage biotech companies (predominantly mid-cap biotech), with the aim of generating 15%+ pa returns over the medium to long term (three to

five years plus). The portfolio is managed by Bellevue Asset Management, which is based in Zurich. The management team comprises Dr Daniel Koller (head), Dr Tazio Storni, Dallas Webb, Felicia Flanigan, Dr Stephen Taubenfeld, Lydia Bänziger, Jan Bootsma, Hugo van Neutegem and Nathalie Isidora-Kwidama. Their average length of service with Bellevue is eight years. Each has their own area of expertise and several have previous experience of managing healthcare investments and/or working in biotech research. Dr. Taubenfeld joined the team in 2013. Ex-Merlin Biomed, his addition strengthens the management team by adding specialist experience in neurology.

The fund manager: Bellevue Asset Management

Managers' view: Approvals to accelerate portfolio earnings

The managers acknowledge recent multiple expansion, but consider that, for investors able to take a longer-term view, valuations remain attractive and that large-cap biotech's current P/E premium over large-cap pharma is justified because of biotech's superior growth prospects. The portfolio remains focused primarily on the large- and mid-cap US companies the managers believe have products addressing areas of high unmet medical need (eg oncology, infectious diseases and metabolic diseases), which are sufficiently differentiated to provide pricing power. 2012 saw 39 new molecular entities (NMEs) approved by the FDA (eight of which were developed by stocks in BION's portfolio). 2013 has been another strong year with 26 NMEs approved so far (nine developed by BION portfolio companies in addition to key indications added for Celgene's Abraxane). There are a record number of products in clinical trials and the managers have identified 17 new products that could come to the market between by the end of 2015 that are being developed by stocks held by BION. The managers believe that this could drive an acceleration of portfolio average earnings growth from a mid-teens percentage today to over 20% in 2015. The managers highlight that, after a 15-year period of substantial investment, biotech has matured and the large caps and an increasing proportion of mid caps are cash generative (Exhibit 3 illustrates that BION's portfolio is tilted towards the mid and large caps and towards cash generative stocks). In the managers' view, biotech will continue to benefit from value creating events that will drive growth in the sector, and they are optimistic on the outlook for the fund and shareholders. M&A activity has been a prominent feature during 2012 and 2013 and the managers expect this to continue through 2014.

Asset allocation

Investment process: Blend of top down and bottom up

The top down part of the process begins with the identification of disease areas where the managers consider major progress is being made and where there is the opportunity to charge premium prices. The managers then look for the individual companies and products best placed to exploit these developments, applying both quantitative and qualitative screens (including an assessment of the quality of management) and consulting doctors and specialists to learn more about different drug candidates. The managers aim to gain an understanding of the treatment mechanism and then to make an assessment of its economic impact. Typically the products identified will be in areas of high unmet medical need, or products that reduce overall healthcare costs because of their higher efficiency or better safety.

BION is unusual, when compared to its UK peers, in that the board has oversight of and signs off all investment decisions. The board is advised by Bellevue Investment Management, a biotech specialist, and members of the board and the management team are experts in the field. The team maintain financial models on c 100 existing and potential investments and, for the most promising ideas, an analyst prepares a detailed investment proposal, which is presented to the board in a

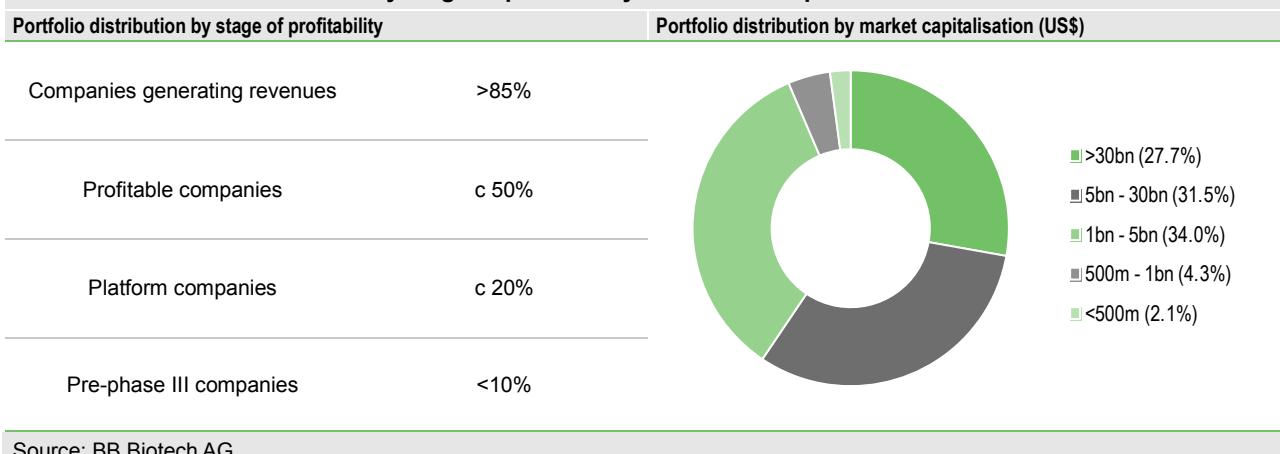
monthly meeting. New investments require board approval but, once a holding is included in the portfolio, the managers have the freedom to trim or add to existing holdings on valuation grounds. Positions continue to be monitored closely, with the validity of investment cases reassessed whenever new information becomes available. If a substantial change occurs, it triggers a proposal to the board to increase the position or to exit it, depending on the rationale. Natural turnover is relatively modest (15-20% a year).

Overview: Global biotech equity exposure

BION maintains a concentrated portfolio of 20-35 holdings, five to eight of which are designated as core holdings. These are stocks where the managers have a high degree of conviction and are comfortable to hold larger, typically 5%+ positions. As at 30 September 2013, BION had 32 holdings in the portfolio of which six were considered to be core holdings. These are all within the top 10 holdings and accounted for 56.6% of the portfolio, while cash accounted for 1.1%. The majority of the portfolio (78.3%) is invested in US stocks and so BION has a significant dollar exposure (it is not policy to hedge foreign currency exposures).

Recent activity and current portfolio positioning

Exhibit 3: Portfolio distribution by stage of profitability and market capitalisation



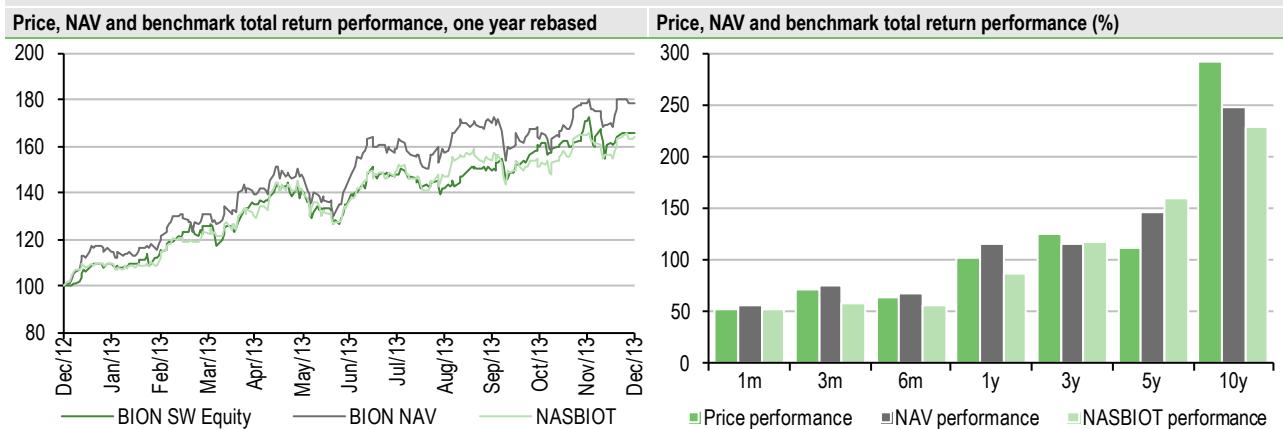
Source: BB Biotech AG

Portfolio turnover saw an uplift in Q3 largely reflecting M&A activity (Amgen made an offer for Onyx Pharmaceutical, while Trius and Optimer were purchased by Cubist). BION also took some profits in Biomarin and The Medicines Company and in Q4 Mylan's purchase of portfolio company Strides is expected to complete. Five new companies have been added during Q3: Pharmacyclics, Regeneron Pharmaceutical, Neurocrine Biosciences, Clovis Oncology and Tesaro. These transactions were largely funded by takeovers of stocks in BION's portfolio. In terms of BION's sectoral allocations, as at 30 September 2013, oncology accounted for 38% of the portfolio, metabolic diseases 16%, infectious diseases 15%, cardiovascular diseases 10%, autoimmune diseases 4% and others 17%. As illustrated in Exhibit 3, the portfolio remains tilted towards mid- and large-cap companies, and towards cash-generative companies.

Performance: Outperformance over 10 years

As illustrated in Exhibit 6, BION's longer-term record is generally one of outperformance against the NASBIOT during the last 10 years, the main exception being a period of underperformance between November 2009 and November 2011. In broad terms, the manager attributes this weaker phase to being overweight large caps (Vertex and Gilead) in 2010 and overweight Actelion, which had a poor year in 2011. NAV outperformance during the last two years has been strong with BION returning 152% (CHF, total return) vs 109% for the NASBIOT. 2012 performance was driven in part

by M&A activity (Human Genome Sciences, Amylin, Pharmasset and Micromet – collectively c 9% of the portfolio at end-December 2011 – were taken over at an average premium of 81%) as well as by a strong performance from BION's core portfolio, excluding Vertex. 2013 saw strong M&A activity (see above), which has contributed positively to performance.

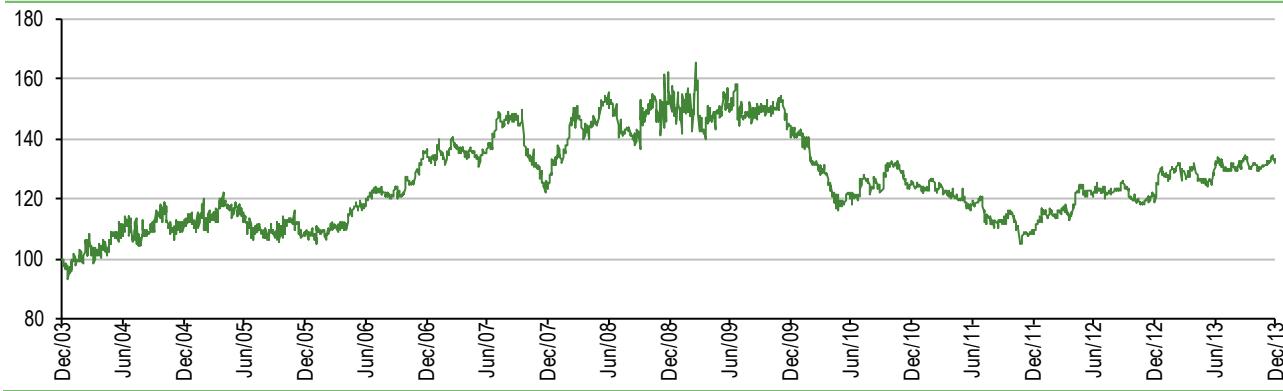
Exhibit 4: Investment trust performance to 31 December 2013


Source: BB Biotech AG, Thomson Datastream, Edison Investment Research

Exhibit 5: Share price and NAV total return performance, difference vs benchmarks (% points), to 31 December 2013

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price versus NASBIOT	1.5	14.6	6.9	15.8	7.6	(48.1)	62.7
NAV versus NASBIOT	4.5	16.9	11.8	28.7	(0.9)	(13.9)	19.4
Price versus MSCI World Healthcare	22.0	33.2	22.9	42.8	44.1	19.5	100.0
NAV versus MSCI World Healthcare	26.0	36.7	28.9	56.8	42.1	55.8	80.4
Price versus DS World Pharma & Biotech	22.6	33.8	23.3	40.4	42.8	8.9	87.1
NAV versus DS World Pharma & Biotech	26.6	37.3	29.3	54.3	40.9	45.2	67.5

Source: BB Biotech AG, Thomson Datastream, Edison Investment Research. Note: Performance calculated in CHF terms.

Exhibit 6: BION NAV total return vs NASBIOT total return, over 10 years, rebased to 100


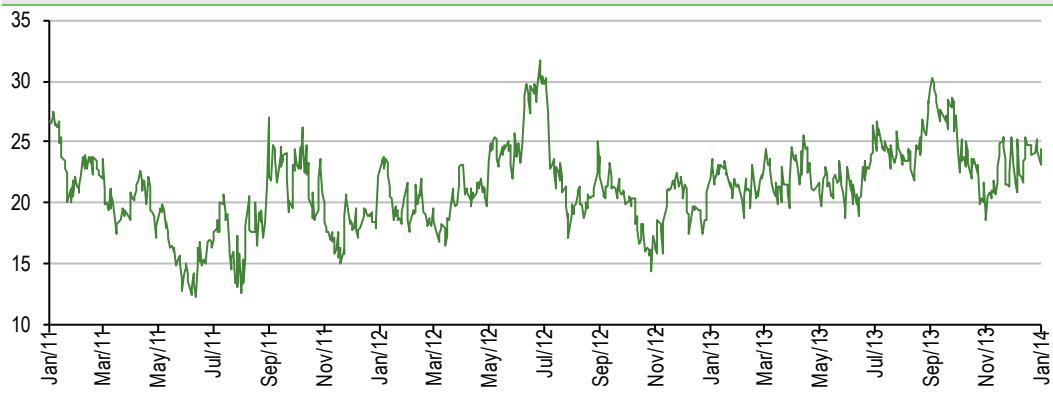
Source: BB Biotech AG, Thomson Datastream, Bloomberg, Edison Investment Research

Discount: Comparable to long-term averages

As Exhibit 7 illustrates, BION's current discount of 24.4% is broadly in line with its five-year average of 22.4% (one-year trading range 18.5% to 30.2%). The widening during 2012, which saw BION's discount reach a three-year high of 31.7%, was not helped by a pause in the dividend payment and uncertainty created by the Vontobel unitisation offer (announced in July and withdrawn in November). At current discount levels, the risk of a substantial expansion does not appear to be high and BION's board has made a commitment to return up to 10% of capital each year (5% through capital distribution and 5% through share buy-backs). It is somewhat surprising that the discount has not already narrowed given recent performance and the distribution commitment. To put this in context, BION's discount is appreciably above its peer group average of 14.1% (3.3%)

excluding BION). During the last year BION has repurchased 573k shares (at a cost of CHF67m). This is significantly less than the 2.3m shares repurchased during the previous 12 months.

Exhibit 7: Discount over three years



Source: Thomson Datastream, Edison Investment Research. Note: Positive values indicate a discount.

Capital structure: Conventional, modest gearing

BION has a conventional capital structure with one class of equity share of par value CHF1.0. BION's shares are listed in Switzerland, Germany and Italy (SIX Swiss, Frankfurt Stock Exchange and STAR Segment). All these exchanges are easily accessible to UK investors. As part of its discount control programme, BION regularly repurchases shares into treasury and periodically cancels a proportion of these. It can also resell stock from treasury and can do so at a discount to NAV. BION has an authorised share capital of 11.85m. We estimate that, following repurchases made since 30 September, BION has 10.23m shares in issue and 1.62m shares in treasury. BION can borrow up to CHF350m and at the end of 30 September 2013 had gross borrowing of CHF125m, equivalent to 6.1% of net assets. This was offset by cash of CHF22.4m to give net gearing of 5.0% of net assets. All borrowings are short-term bank loans. The management fee, from 1 January 2014, has been reduced to 1.1% of the average market capitalisation (previously 1.2%) but the previous cap on the total management fee of CHF1.0bn has been removed. At the current market cap, this increases the level of charges modestly. The board believes this will bring shareholders' interests into better balance with those of the portfolio manager. There is no performance fee and the management contract may be terminated at each year end. Ongoing expenses for the year ended 31 December 2012 were 1.45% (this excludes one-off legal and other expenses, mainly related to the Vontobel approach). This compares with 0.88% for 2011 (the basis of the calculation of the management fee changed last year resulting in an increase in fees). BION has an indefinite life and there is no specific mechanism to wind up the company.

Dividend policy: 5% cash distribution, 5% buybacks pa

A new distribution policy was announced for the year ended 31 December 2012 whereby BION makes a cash distribution equivalent to approximately 5% of BION's share price at the year end. Accordingly, BION made a cash distribution of CHF4.50 per share, approximately equivalent to 5% of BION's share price of CHF88.5 at 31 December 2012. In addition to this BION has also committed to returning an additional 5% via the share buyback programme during the year. In contrast to the more mature pharmaceutical sector, the biotech sector has historically not generated much income for investors, with returns principally provided by capital gains (as reflected in the peer group yield statistics in Exhibit 8 below). From 2003 to 2010, BION paid dividends, primarily from capital, as part of a discount management policy (according to a formula that linked

distributions to the size of BION's discount – the larger the discount, the larger the dividend). No dividend was paid for 2011, while the board reviewed BION's discount management policy.

Peer group comparison

Exhibit 8 provides a peer group comparison for BION against its UK-listed peers. The peer group is relatively small (five constituents) and, while they all invest in biotechnology companies, there are marked differences in their investment objectives. Within this peer group BION ranks first over one and three years, and second over five and 10 years when considering share price total return (CHF terms). In terms of risk-adjusted returns, BION has the highest one-year Sharpe ratio for NAV and second highest Sharpe ratio for price in its peer group. BION is the largest fund in the group and while its ongoing charges are above average, its discount is the widest.

Exhibit 8: Biotechnology and life sciences sector, as at 3 January 2013

Company	Share price total return on CHF 100				Ongoing charges (%)	(Disc)/ prem. (%)	Net gearing (100=no gearing)	Five-year dividend growth (%)	Div. yield (%)	Sharpe ratio NAV one year	Sharpe ratio price one year	NAV volatility one year	Price volatility one year
	One year	Three years	Five years	10 years									
Sector average	152.9	223.4	249.8	273.9	1.3	(14.1)	102.5	284.0	2.6	2.7	3.4	20.1	19.5
BB Biotech AG	165.6	251.0	256.0	196.7	1.5	(24.4)	105.0	400.0	3.2	2.9	3.6	24.1	22.5
Biotech Growth	141.7	248.8	317.3	236.3	1.3	(0.8)	100.0	0.0	2.6	2.5	21.8	22.7	
International Biotechnology	142.7	194.2	213.1	128.3	1.7	(9.5)	100.0	0.0	2.0	2.9	19.0	13.1	
Polar Capital Glb Healthcare	115.2	138.7			1.1	(5.1)	99.0	0.0	2.4	2.1	1.3	8.8	14.9
Worldwide Healthcare	143.8	178.0	208.5	101.0	0.7	(2.3)	100.0	27.0	1.3	2.8	3.9	13.3	14.0

Source: Morningstar

The board: Executive board structure

The board members are advised by an external investment adviser, but sign off all major investment decisions. Therefore, none of the board should be considered as non-executive. The board consists of Chairman Dr Erich Hunziker (appointed as a director in 2011 and as chairman in 2013) and two directors, Dr Clive Meanwell (appointed as a director in 2004) and Professor Dr Dr Klaus Strein (appointed as a director in March 2013).

Dr Hunziker was CFO of Roche. Professor Strein is a professor at the University of Heidelberg and has held top-level research positions at Boehringer Mannheim and Roche. Dr Meanwell is executive chairman and CEO of The Medicines Company and was a founding partner and managing director of one of the world's largest dedicated investors in life sciences.

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