

# HBM Healthcare Investments

Diversified private/public healthcare portfolio

HBM Healthcare Investments (HBMN) is a Swiss-listed, globally diversified healthcare fund that blends listed equities with private companies held both directly and via funds. It invests for long-term capital growth, and many of the listed stocks in its portfolio are those it has backed from an early stage as private companies. The private exposure serves a dual purpose of accessing potentially high-growth investments and limiting NAV volatility, while some of the more mature companies in the listed portfolio may become takeover targets. The fund is well spread by clinical focus and has a bias towards companies with products already on or close to the market. Following a number of successful IPOs and trade sales, HBMN is looking to increase its private company exposure, and holds a short position in a biotech index ETF as a protection against a market downturn. A high distribution policy provides a yield of c 5%.

12 months ending	Share price (%)	NAV (%)	MSCI World Health Care (%)	NASDAQ Biotech (%)	FTSE All-Share (%)
30/06/13	20.8	21.5	27.5	34.4	14.0
30/06/14	54.7	55.7	21.2	39.2	19.5
30/06/15	26.0	14.5	24.1	52.0	(0.5)
30/06/16	(2.5)	11.4	(0.0)	(27.1)	(9.4)
30/06/17	28.4	9.5	8.5	19.0	12.8

Source: Thomson Datastream. Note: All % on a total return basis in CHF.

## Investment strategy: Long-term growth focus

HBMN is managed by specialist Swiss healthcare investment firm HBM Partners, which has teams covering both listed and private healthcare companies. Most investment team members have a life sciences background, enabling them to assess potential investments from a clinical as well as a financial perspective. The approach is generally long term and low turnover, although some investments may be made on a more tactical basis in anticipation of M&A activity.

## Market outlook: Value still to be found

The global healthcare market is underpinned by strong fundamentals in the form of demand from ageing populations, scientific innovation, new markets in the developing world and global economic growth enabling greater healthcare spending. While the sector can be vulnerable to political interference and fragile investor sentiment, valuations remain favourable versus the US equity market and are largely in line with global equities.

## Valuation: Discount narrows as 5% yield attracts

At 15 July 2017, HBMN traded at an 18.3% discount to NAV. While this is wider than its peers that invest wholly or mainly in listed equities, it is narrower than both the short- and longer-term averages of c 26-27%. Management reports strong demand from investors attracted by the c 5% yield as an important factor in recent discount narrowing; however, the rating arguably reflects the private company exposure – by way of context, the AIC Private Equity sector is on a 14.5% average discount compared with 3.5% for the AIC investment company universe.

## Investment companies

18 July 2017

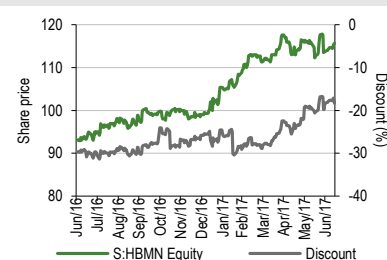
**Price** CHF115.7  
**Market cap** CHF810m  
**AUM** CHF996.0m

NAV\* CHF141.6  
Discount to NAV 18.3%

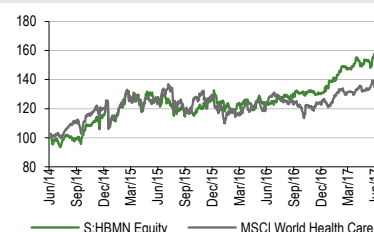
\*Including income. As at 15 July 2017.

Yield 5.0%  
Ordinary shares in issue 7.0m  
Code HBMN  
Primary exchange SIX  
AIC sector N/A

## Share price/discount performance



## Three-year performance graph



52-week high/low CHF117.8 CHF93.0  
NAV\* high/low CHF156.5 CHF131.5

\*Including income.

## Gearing

Gross\* 10.0%  
Net\* 2.0%

\*As at 30 June 2017.

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

### Exhibit 1: Company at a glance

#### Investment objective and fund background

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 publicly listed holdings, many of which began as private equity investments.

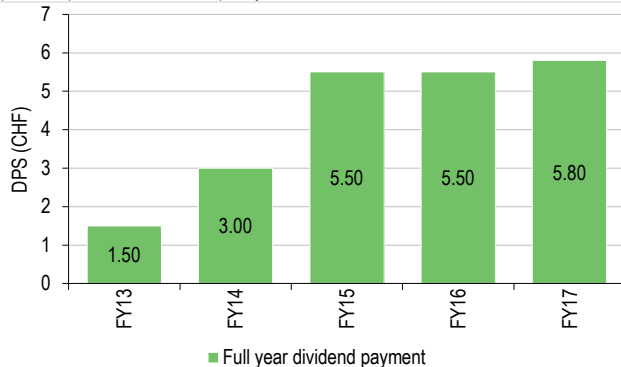
#### Recent developments

- 23 May 2017: Acquisition of privately held True North Therapeutics (in which HBMN held a c 3% stake, having invested \$10m in October 2016) by Bioverativ for an upfront payment of \$400m plus assumed cash. Further payments of up to \$425m are contingent on the achievement of future development, regulatory and sales milestones.
- 16 May 2017: Annual results for the period ended 31 March 2017. CHF137m of profit for the year. NAV total return of 15.2% and share price total return of 17.5%. Cash distribution of CHF5.80 per share to be paid on 30 June.

Forthcoming		Capital structure		Fund details	
AGM	June 2018	Ongoing charges	1.5%	Group	HBM Partners
Quarterly results	25 July 2017	Net gearing	2.0%	Manager	Team managed
Year end	31 March	Annual mgmt fee	0.75% NAV + 0.75% market cap	Address	Bundesplatz 1, 6300 Zug, Switzerland
Dividend paid	June	Performance fee	Yes (see page 7)	Phone	+41 41 710 75 77
Launch date	July 2001 (listed Feb 2008)	Trust life	Indefinite	Website	<a href="http://www.hbmhealthcare.com">www.hbmhealthcare.com</a>
Continuation vote	No	Loan facilities	CHF100m bond issue		

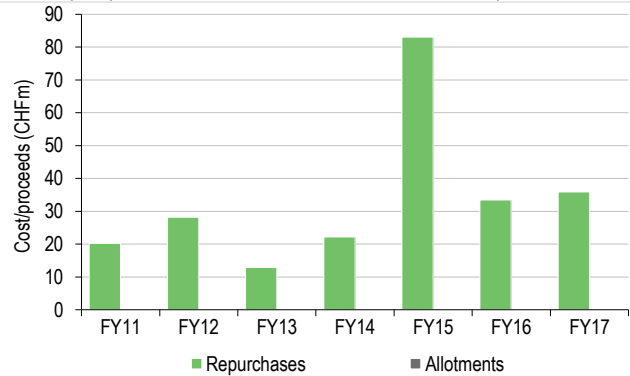
#### Dividend policy and history (financial years)

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.

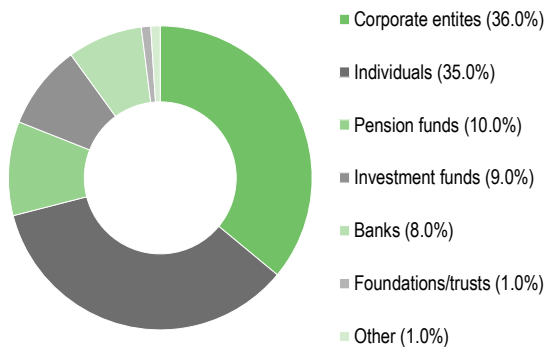


#### Share buyback policy and history (financial years)

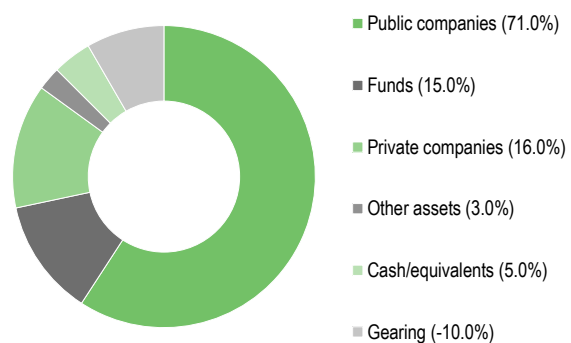
HBMN buys back shares in the market to help manage its discount. Its current buyback authority was granted in October 2016. The FY15 figure includes an issue of put options, which saw an additional 564,897 shares repurchased.



#### Shareholder base (as at 30 June 2017)



#### Portfolio by investment type (as at 30 June 2017)



#### Top 10 holdings (as at 30 June 2017)

Company	Country	Sector	Portfolio weight %	
			30 June 2017	30 June 2016*
Advanced Accelerator Applications**	France	Imaging and radiotherapy	10.4	10.8
Vectura	UK	Respiratory diseases	8.5	16.1
Pacira Pharmaceuticals**	US	Pain management	4.6	4.0
Cathay Industrial Biotech***	China	Industrial polymers	3.9	4.7
Genmab	Denmark	Oncology	3.0	4.6
Ultragenyx	US	Rare genetic disorders	2.6	0.8*
Nabriva**	US	Infectious diseases	2.6	2.4*
Eesperion	US	Cholesterol management	2.4	0.8*
Incyte	US	Oncology	2.0	3.6
AnaptysBio**	US	Inflammatory/oncology	2.0	0.7*
<b>Top 10</b>			<b>45.4</b>	<b>54.0</b>

Source: HBM Healthcare Investments, Edison Investment Research, Bloomberg, Morningstar. Note: \*Not in June 2016 top 10. N/A where not in portfolio at 30 June 2016. \*\*Originally held in private portfolio. \*\*\*Private company.

## **Market outlook: Healthcare sector still offers value**

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There are several fundamental factors underpinning growth in the global healthcare sector. Ageing populations mean rising demand for medical treatment, while global economic growth supports greater spending on healthcare, and a growing middle class in emerging economies is leading to new market opportunities for healthcare companies. Meanwhile, greater understanding of the human body and disease processes is feeding into innovation in treatments.

However, as an investment sector, healthcare can be vulnerable to shifting sentiment, particularly from non-specialist investors who may buy into the sector when performance has been good and pull out in times of heightened risk aversion. The political cycle also has an impact, particularly in the US, which is the largest global healthcare market and also the domicile of many of the largest listed companies in the sector. This has been evident at several points in the past two years, notably immediately before and after the US presidential election in November 2016, when the sector sold off in expectation of a Hillary Clinton victory and then rebounded just as sharply following the election of Donald Trump.

While healthcare stocks are no longer empirically cheap on a forward P/E basis versus global equity markets, they remain at an appreciable (c 10%) discount to the US market, suggesting investors may still find value in the sector against a backdrop of generally high equity market valuations.

## **Fund profile: Established public/private health specialist**

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HBM Healthcare Investments (initially HBM BioVentures) was set up in 2001 and has been listed on the Swiss SIX Exchange since February 2008. Having begun life as a biopharmaceutical private equity specialist, it has evolved into a globally diversified healthcare fund investing in listed equities and in private companies both directly and via private equity funds. Many of the public investments began in the private portfolio and have been retained following their listing.

The fund is managed from Zug, Switzerland by specialist healthcare investor HBM Partners. It uses the MSCI World Health Care index as a reference benchmark, although this is an imperfect comparator as it contains only listed investments. HBMN invests for capital growth, although a high distribution policy has been in place as a means of rewarding shareholders and limiting the discount to NAV. The fund currently yields 5.1%.

HBMN's investments are held through a Cayman Islands subsidiary. Changes to IFRS accounting rules for investment companies mean the subsidiary holding can no longer be consolidated in the accounts and must now be presented as a single item in the balance sheet at fair value through profit and loss. However, in order to provide visibility to investors, the company continues to present information on the subsidiary through appendices to the accounts.

## **The fund manager: HBM Partners**

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### **The managers' view: Balancing risks and rewards**

HBMN's CEO Dr Andreas Wicki and CFO Erwin Troxler see continued positive fundamentals for the healthcare sector, underpinned by demographics and economic growth. Some expected clinical catalysts within the portfolio have been delayed (such as FDA approval for Advanced Accelerator Applications' (AAA) Lutathera, and Vectura's generic version of asthma drug Advair). For AAA, the problems have mainly been with the format of the data supplied to the regulator, and the team still expects an approval, albeit later in the year. Vectura has yet to hear back from the FDA to better evaluate when an approval for generic Advair by partner Hikma Pharmaceuticals could occur.

Meanwhile, pain specialist Pacira has had positive Phase III results for its Exparel medication in total knee replacement, with data for the treatment as a nerve block for extremities due over the summer, which could add further upside to a stock that has already risen more than 50% year-to-date.

The fund's diversified portfolio has a bias to later-stage assets, but some holdings have little to no clinical risk. One of the largest holdings, Cathay Industrial Biotech, is a producer of long-chain dicarboxylic acids and 'green' nylon. A new manufacturing facility coming on-stream in autumn 2017 will significantly increase the Chinese company's production capacity, potentially opening up access to new textile markets and increasing the chance of an IPO within the next two years.

The managers note that public company valuations in the healthcare sector in many cases remain below long-term averages, offering share price upside potential, as well as increasing the likelihood of M&A among mature companies. During FY17, portfolio holdings Relypsa, Anacor and Medivation were taken over, producing significant gains (CHF27.4m) for the fund. HBMN has made a number of investments in mature public companies that it sees as likely future takeover candidates.

## Asset allocation

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### Investment process: Global portfolio with private equity core

HBMN invests globally in public and private companies from across the healthcare spectrum, principally biopharmaceuticals, generic drugs, medical devices and diagnostics. Most of the investment professionals at HBM Partners have an academic or professional background in life sciences. They are organised into two teams, covering listed and private companies. The teams can draw on their own global industry networks as well as external expertise, and weekly meetings involving both teams facilitate the sharing of information on clinical and market developments.

Although the majority of HBMN's current portfolio is in listed investments, more than one-third of these by value began in the private portfolio, illustrating the importance of the fund's private equity focus. Private investments may be made directly or via funds (currently 16% and 15% of total assets respectively). Most private investments are valued at cost, which means there may be significant upside potential, for example in the event of an IPO. Clinical data releases or financing rounds may be used to update valuations. Public investments are valued based on their share price. As a result, the public part of the portfolio may be more volatile, even though the mainly less mature companies in the private portfolio may be more risky.

The investment approach is long term and relatively low turnover, and broadly diversified by geography, investment type, development stage and clinical focus. The managers may use hedging techniques to mitigate volatility in the listed portfolio; currently there is a short index position via an ETF tracking the S&P Biotech index, equal to c 16% of the listed portfolio, which will limit the downside in the event of a correction in the biotech market.

### Current portfolio positioning

At 31 May 2017, HBMN's portfolio was 71% invested in public companies, 15% in private equity funds and 16% directly in private companies. Cash and other assets (8%) and gearing (10%) largely offset each other. The managers describe the strategy as having an emphasis on US dollar investments (67%), and mainly invested in private companies (including funds) and those that originated in the private portfolio (seven out of 39 listed holdings, making up 34.7% of assets in the public portfolio or 26.0% of total assets at the 31 March year-end). While many of the private holdings may be earlier-stage companies, there is a focus on managing risk through holding a majority of the portfolio in companies with products on or close to market – as shown in Exhibit 3 (left-hand chart), 76% of the fund is invested in companies with products already on the market or in Phase III trials.

From a clinical perspective, the portfolio is broadly diversified (Exhibit 2), with the largest exposure being to oncology. Top holding AAA makes up c 10pp of the 26% oncology weighting, and HBMN's managers say the expected approval of its Lutathera treatment for neuroendocrine tumours (which was delayed from early 2017 after the FDA requested data in a different format) is an important catalyst for the portfolio. The majority of the next-biggest exposure, respiratory diseases, is in UK company Vectura, the second-largest holding since it merged with HBMN's long-held former private investment Skyepharma in 2016. The managers view the Vectura investment case as intact despite a recent regulatory setback leading to a sharp fall in the share price (See Performance section).

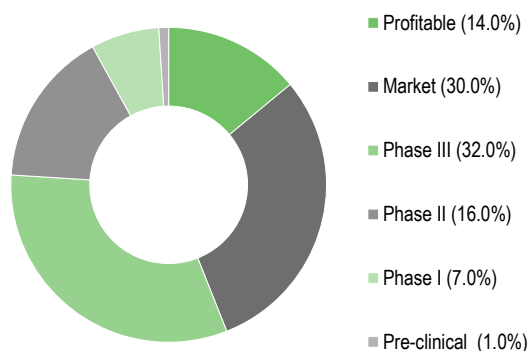
**Exhibit 2: Portfolio sector positions (% unless stated)**

	Portfolio end-June 2017	Portfolio end-June 2016	Change (pp)
Oncology	26.0	28.0	(2.0)
Respiratory diseases	11.0	19.0	(8.0)
Metabolic diseases	11.0	8.0	3.0
CNS disorders	6.0	5.0	1.0
Infectious diseases	6.0	6.0	0.0
Pain	6.0	5.0	1.0
Autoimmune diseases	5.0	0.0	5.0
Medtech/diagnostics	4.0	8.0	(4.0)
Others	25.0	21.0	4.0
	<b>100.0</b>	<b>100.0</b>	

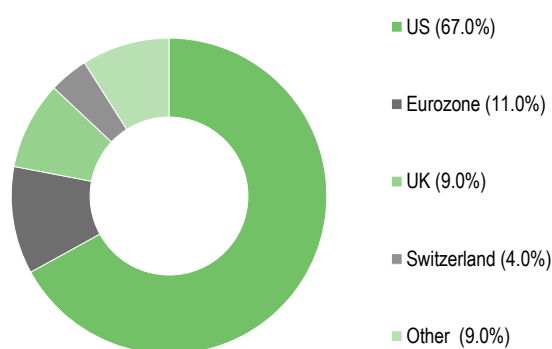
Source: HBM Healthcare Investments, Edison Investment Research

**Exhibit 3: Portfolio breakdown by stage and currency as at 30 June 2017**

Portfolio analysis by stage\*



Portfolio by region/currency



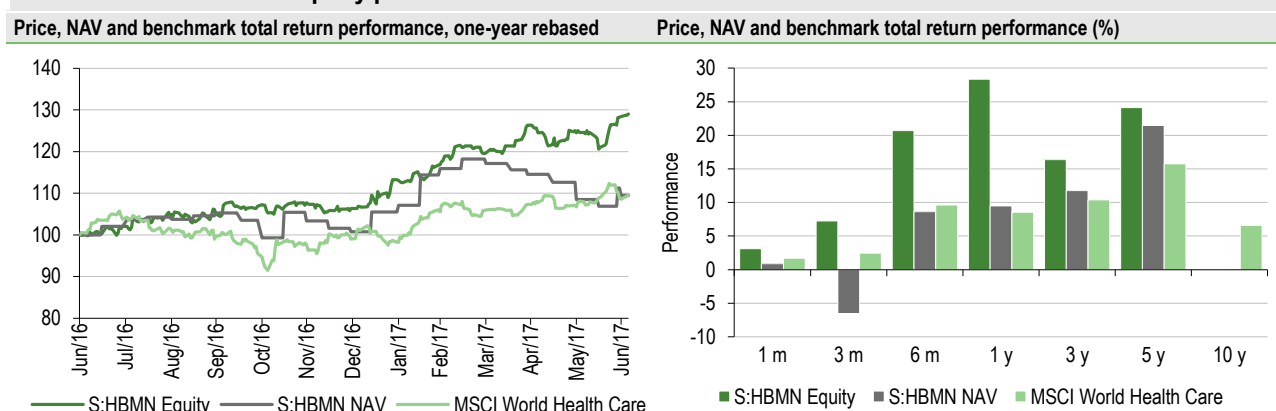
Source: HBM Healthcare Investments, Edison Investment Research. Note: \*Classified by most advanced stage.

HBMN's managers have stated that they are actively seeking to increase the private company weighting, following the IPOs of two private holdings, AnaptysBio and ObsEva, in FY17. New private holdings during the financial year included US-based Neurelis, which is developing a nasal delivery format for diazepam to be used in treating epileptic seizures; Vitaeris, a Canadian company developing an antibody treatment for inflammatory diseases; 1mg, a healthcare-focused e-commerce specialist in India; and True North Therapeutics, which was bought by the fund in October 2016 but quickly acquired by Bioverativ (see [our blog](#) from May 2017). The most recent new private investment was a CHF20m growth capital stake in Central and Eastern Europe-focused distribution firm Amicus Partners, formed by the management team of former holding PharmaSwiss, which was taken over by Valeant Pharmaceuticals in 2011. The managers say Amicus is a good fit in the portfolio as it is exposed to growing end-markets and does not have clinical development risk.

Positions have been taken in some larger, liquid public companies partly in anticipation of M&A activity, which would be a source of cash for new private investments. Should a market setback dampen M&A and IPO activity, the CHF133m short position in an ETF tracking the S&P Biotech index would act as a partial protection of the currently large exposure in listed companies, and could provide an alternative liquidity source by paying out if the index goes down, potentially allowing the managers to make investments in promising companies at depressed valuations.

## Performance: Positive returns despite recent setback

**Exhibit 4: Investment company performance to 30 June 2017**



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

Over 12 months to 30 June 2017, HBMN's share price total return performance has been strong in both absolute and relative terms, narrowing the discount to NAV to a level well below short- and longer-term averages (see Discount section). NAV total returns have been closer to the MSCI World Health Care benchmark over six months, one and three years. Over five years, share price and NAV total returns have both been ahead of the benchmark. A fall in the NAV over FY18 to date (31 March to 30 June) has mainly been caused by listed investments, in particular a 26.7% decline in the share price of second-largest holding Vectura, after the FDA failed to approve its generic version of GlaxoSmithKline's Advair asthma treatment. While HBMN's managers believe the drug will ultimately be approved, it is not yet clear what the FDA's concerns are, or the timescale over which the issues could be resolved. Strength in the Swiss franc versus the US dollar has also weighed on returns from dollar-denominated investments (67% of the portfolio).

**Exhibit 5: Share price and NAV total return performance, relative to indices (%)**

	One month	Three months	Six months	One year	Three years	Five years	SI
Price relative to MSCI World Health Care	1.4	4.7	10.1	18.3	17.2	41.7	(22.6)
NAV relative to MSCI World Health Care	(0.8)	(8.8)	(0.9)	0.9	3.8	27.0	(22.4)
Price relative to NASDAQ Biotech	(4.0)	5.9	9.2	7.9	19.6	19.5	(52.1)
NAV relative to NASDAQ Biotech	(6.1)	(7.7)	(1.7)	(8.0)	5.9	7.1	(52.0)
Price relative to FTSE All-Share	6.2	6.4	15.5	13.8	55.2	112.9	60.7
NAV relative to FTSE All-Share	3.9	(7.3)	4.0	(3.0)	37.4	90.8	61.2

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-June 2017, in CHF terms. Geometric calculation.

**Exhibit 6: NAV performance relative to MSCI World Health Care in CHF over five years**

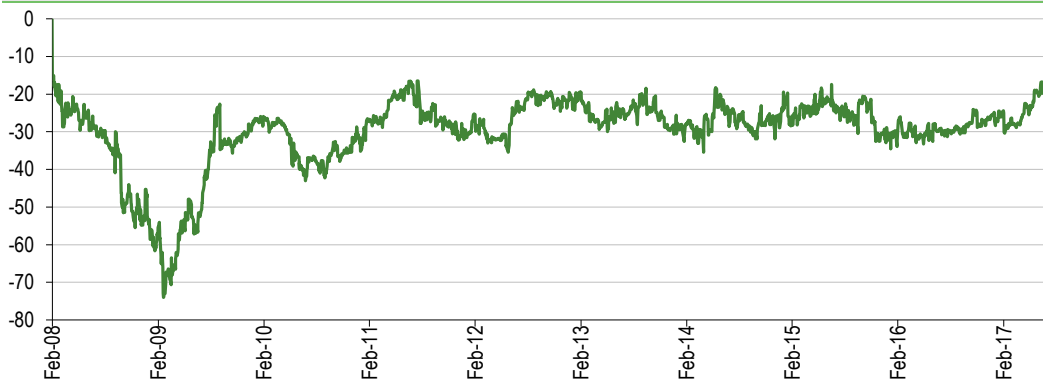


Source: Thomson Datastream, Edison Investment Research

## Discount: Narrower than average but wider than peers

At 15 July 2017, HBMN's share price discount to NAV stood at 18.3%. This was substantially narrower than both short- and longer-term averages – over one, three and five years respectively, the discount has averaged 26.4%, 26.6% and 25.8%. The narrowing can be seen in the context of smaller discounts for closed-end funds generally: at 14 July the average discount for the AIC universe (excluding 3i and venture capital trusts) was 3.5%, which is close to an all-time low. The fact that HBMN's discount is wider than its peers' (see Exhibit 8) may be attributed to its c 30% exposure to unlisted investments (the average discount for the AIC Private Equity sector at 14 July was 14.5%). Buybacks and the high distribution policy may be instrumental in keeping up demand and limiting discount widening.

**Exhibit 7: Share price discount to NAV (including income) since inception (%)**



Source: Thomson Datastream, Edison Investment Research

## Capital structure and fees

HBMN is a closed-end investment company, domiciled and listed in Switzerland. It has 7.0m ordinary shares in issue (excluding treasury shares). During FY17, the fund bought back 357,500 shares into treasury and 400,000 treasury shares were cancelled. Gearing is available through a CHF100m issue (in two tranches) of secured bonds, in place since 2015, although this is largely offset by cash holdings so the net gearing position is 2.0% at 30 June.

The manager, HBM Partners, receives an annual management fee equal to 0.75% of market capitalisation plus 0.75% of NAV. It may also be paid a performance fee of 15% of outperformance if the year-end NAV is more than 5% above the level at which such a fee was last paid. For FY17, a performance fee of CHF22.1m (2.0% of NAV) was paid (FY16: no performance fee). Excluding the performance fee, we calculate ongoing charges for FY17 to be 1.5% (FY16: 1.6%).

## Dividend policy and record

Although healthcare is not generally a high-yielding area of the market, HBMN – in common with some of its peers – has recognised the importance to investors of receiving some of their return as income, and has adopted a high distribution policy under which it aims to return c 5-8% of NAV each year through a combination of capital distributions and share buybacks. Since the policy was put in place in FY13, HBMN has grown its distribution by a compound annual rate of 40%, although this reflects a low starting point (CHF1.50 in FY13, representing a dividend yield of c 3%). The FY17 distribution of CHF5.80 is 5.5% higher than the CHF5.50 paid in respect of FY16 and FY15, and equates to a dividend yield of 5.1% based on the current share price.

## Peer group comparison

In Exhibit 8 below we show HBMN's performance in the context of a peer group of biotech and healthcare funds, four of which are listed in the UK while two (HBMN and BB Biotech) are based in Switzerland. We have excluded peers with less than one year's performance history and all figures are in Swiss franc terms. Returns have been below the peer group average over one, three and five years, although if the three biotech specialists are excluded, HBMN has outperformed the simple average return of the more generalist healthcare funds over all periods shown. Ongoing charges are above average but reflect the greater complexity of managing a fund with material exposure to private companies (the trust with the second-highest ongoing charges figure, International Biotechnology Trust, has c 10% invested in unlisted holdings). The discount to NAV is significantly wider than peers', again probably reflecting the private equity exposure, while net gearing is below average. The dividend yield is the highest in the group.

**Exhibit 8: Selected peer group as at 12 July, in CHF terms**

% unless stated	Market cap CHFm	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	Ongoing charge	Perf. fee	Discount (ex-par)	Net gearing	Dividend yield (%)
<b>HBM Healthcare Investments</b>	<b>807.3</b>	<b>9.5</b>	<b>34.7</b>	<b>154.9</b>	<b>1.5</b>	<b>Yes</b>	<b>(18.2)</b>	<b>102</b>	<b>5.1</b>
BB Biotech	3,460.2	27.0	79.0	230.3	1.1	No	(6.3)	103	4.7
Biotech Growth Trust	445.0	13.6	32.1	144.4	1.1	Yes	(6.2)	110	0.0
International Biotechnology Trust	228.6	12.5	53.2	140.1	1.4	Yes	(7.2)	100	3.8
Polar Capital Gbl Healthcare	261.3	2.1	17.8	67.6	1.1	Yes	0.6	100	2.0
Worldwide Healthcare Trust	1,184.9	11.8	51.4	140.7	0.9	Yes	1.3	109	0.9
<b>Weighted average</b>		<b>19.5</b>	<b>61.6</b>	<b>188.3</b>	<b>1.1</b>		<b>(6.1)</b>	<b>104</b>	<b>3.8</b>
<b>HBMN rank in peer group</b>	<b>3</b>	<b>5</b>	<b>4</b>	<b>2</b>	<b>1</b>		<b>6</b>	<b>4</b>	<b>1</b>

Source: Morningstar, Edison Investment Research. Note: Performance data at 10 July. TR=total return. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared).

## The board

There are six non-executive directors on the board of HBMN, all of whom have specialist pharma and biotech expertise and are shareholders of the fund. Chairman Hans Peter Hasler has been a director since 2009 and formerly worked at Wyeth and Biogen. Dr Heinz Riesenhuber, the vice-chairman, has served on the board since inception in 2001; he is a German MP and former minister for scientific research. Dr Rudolf Lanz was appointed in 2003 and has a background in corporate finance and law, while former Glaxo Wellcome CEO and chairman Robert A Ingram has been a director since 2006. Dr Eduard E Holdener, an oncologist, has served on the board since 2009, while the newest director, Mario G Giuliani, is president and CEO of Italian healthcare company Giuliani, and was appointed in 2012.

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