EDISON

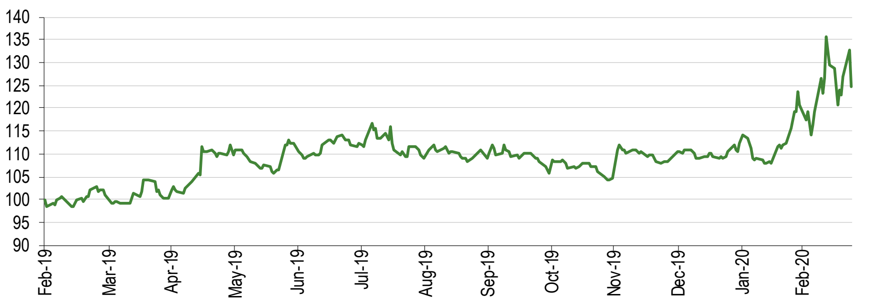
# HBM Healthcare Investments

## Keeping calm amid the market turmoil

Investment companies
Biotech and healthcare

**HBM Healthcare Investments' (HBMN's) portfolio is still in line for a positive FY20 (NAV TR +13.2% at 24 March 2020 compared with the 31 March FY19 year-end), with the share price largely flat (+1.3%) over the 51 weeks despite the recent global stock market sell-off. Its managers attribute the relative strength to a combination of strong IPO activity from the private portfolio, taking profits in some listed holdings as markets peaked in February, and hedging (through short index positions) in the public portfolio, which generated proceeds of c CHF45m as indices declined. The team is remaining prudent with regard to new private investments (only one has been made so far in 2020), in expectation of more attractive valuations later in the year, but is willing to deploy some of its large cash pile in response to value opportunities in listed markets. Meanwhile, it remains on track to declare a 3–5% distribution for FY20.**

**HBMN has outperformed in more volatile recent market conditions**



Source: Refinitiv, Edison Investment Research. Shows HBMN NAV total return relative to MSCI World Health Care Index.

## The market opportunity

Although the near-term picture for all equity investments may be clouded by fear and uncertainty as a result of the COVID-19 pandemic, the healthcare sector's positive fundamentals remain intact in terms of clinical innovation, a supportive regulatory backdrop, ageing populations and increasingly affluent middle classes in emerging markets. Many of the most innovative companies may still be in private hands.

## Why consider investing in HBMN?

- Very strong performance track record in up and down markets.
- Differentiated by large (c 45%) exposure to innovative private companies.
- Long-term focus, with many listed holdings originating from the private portfolio.
- High distribution policy, with a distribution yield averaging c 5%.
- Recent market weakness has seen shares fall from a c 10% premium to NAV to a double-digit discount.

## Discount widens amid recent market volatility

At 24 March 2020, HBMN's shares traded at a 15.4% discount to NAV. This compares with a 10-year high premium of 10.1% at 13 February. Management reports recent buying activity based on the lower valuation and the higher dividend yield, currently 4.4% based on the FY19 distribution.

**25 March 2020**

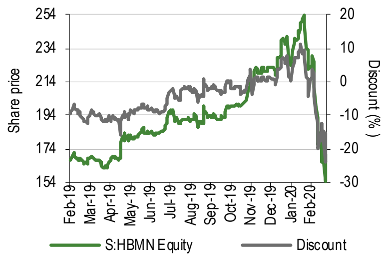
| | |
|---|---|
| **Price** | **CHF171.00** |
| **Market cap** | **CHF1,190.2m** |
| **AUM** | **CHF1,407.4m** |

| | |
|---|---|
| NAV per share* | CHF202.21 |
| Discount to NAV | 15.4% |

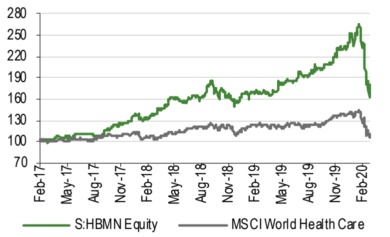
*Including income. As at 24 March 2020.

| | |
|---|---|
| Yield | 4.4% |
| Ordinary shares in issue | 7.0m |
| Code | HBMN |
| Primary exchange | SIX |
| AIC sector | N/A |

### Share price/discount performance




### Three-year performance vs index




| | | |
|---|---|---|
| 52-week high/low | CHF253.50 | CHF154.20 |
| NAV* high/low | CHF231.25 | CHF185.20 |

*Including income.

### Gearing

| | |
|---|---|
| Gross* | 6.5% |
| Net cash* | 6.2% |

*As at 29 February 2020.

### Analysts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Edison profile page


***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 (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.

**Recent developments**

- 3 February 2020: Successful IPO of portfolio company Arcutis Biotherapeutics, a specialist in skin diseases, with a lead candidate in Phase III development for the treatment of plaque psoriasis and contact dermatitis. HBMN invested an additional $7.65m at the IPO and now holds 1.74m shares.
- 3 January 2020: HBMN NAV +33.0% and share price +48.0% in calendar 2019; +20.2% and +36.3% for 9M20 (ended 31 December).

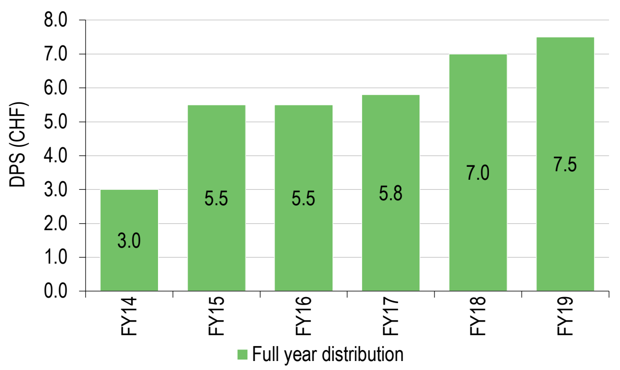
| Forthcoming | | Capital structure | | Fund details | |
|---|---|---|---|---|---|
| AGM | June 2020 | Ongoing charges | 1.41% (FY19) | Group | HBM Partners |
| Annual results | May 2020 | Net cash | 6.2% | Manager | Team-managed |
| Year end | 31 March | Annual mgmt fee | 0.75% NAV + 0.75% market cap | Address | Bundesplatz 1, |
| Dividend paid | September | Performance fee | Yes (see page 10) | | 6300 Zug, Switzerland |
| Launch date | July 2001 (listed Feb 2008) | Company life | Indefinite | Phone | +41 41 710 75 77 |
| Continuation vote | None | Loan facilities | CHF100m bond issue | Website | www.hbmhealthcare.com |

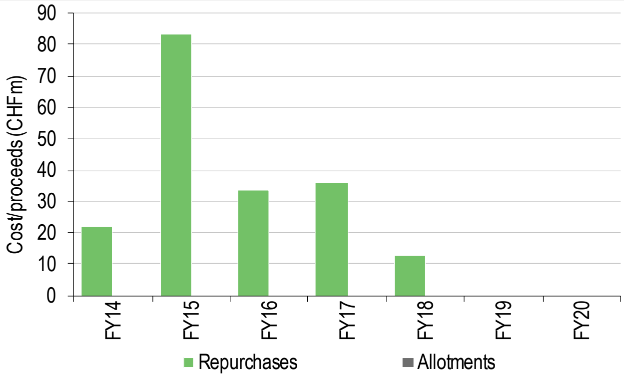
**Dividend policy and history (financial years)**

Since FY13, HBMN has followed a policy focused on shareholder value, whereby c 3–5% is returned to shareholders annually as a capital distribution (c 5–8% total return of capital including buybacks), subject to portfolio performance and liquidity.

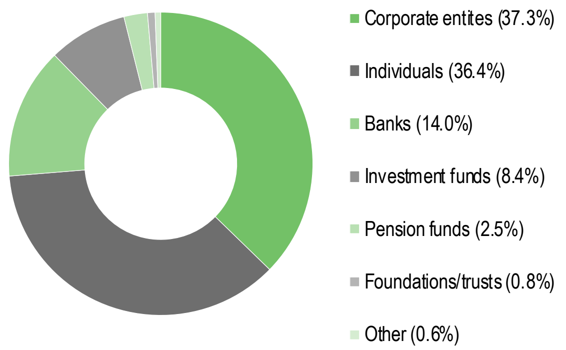
**Share buyback policy and history (financial years)**

HBMN may buy back shares in the market to help manage the discount. Its current buyback programme began in June 2019 but is as yet unused. The FY15 figure includes an issue of put options (564,897 additional shares bought back).

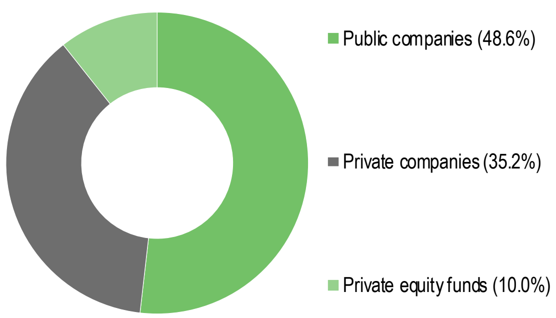



**Shareholder base (as at 29 February 2020)**




**Exposure by investment type (% of NAV at 29 February 2020, excl. hedges)**




**Top 10 holdings (as at 29 February 2020)**

| Company | Country | Sector | Portfolio weight % | |
|---|---|---|---|---|
| | | | 29 February 2020 | 31 March 2019* |
| Shanghai Cathay Biotech** | China | Industrial polymers | 11.3 | 10.2 |
| Y-mAbs*** | Denmark | Cancer immunotherapy | 4.4 | 6.1 |
| Viela Bio*** | US | Autoimmune/inflammation | 4.1 | N/A |
| Harmony Biosciences** | US | Narcolepsy/cataplexy | 3.5 | 2.6 |
| Swixx Biopharma*** | Switzerland | Distribution | 2.3 | 1.8 |
| Argenx | Belgium/US | Oncology/autoimmune | 2.2 | 3.7 |
| Pacira Pharmaceuticals*** | US | Pain management | 2.2 | 2.9 |
| SpringWorks Therapeutics*** | US | Oncology | 2.1 | 1.0 |
| Neurelis** | US | Epilepsy | 2.1 | 3.0 |
| Arcutis Biotherapeutics*** | US | Dermatology | 1.8 | N/A |
| **Top 10 (% of portfolio)** | | | **38.7** | **39.3** |

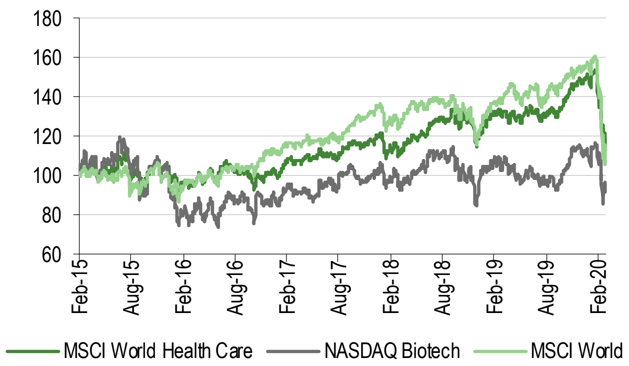
Source: HBM Healthcare Investments, Edison Investment Research, Bloomberg, Morningstar. Note: *N/A where not in 31 March 2019 (end-FY19) portfolio. **Private company. ***Originally held in private portfolio.

## Market outlook: Healthcare in the spotlight

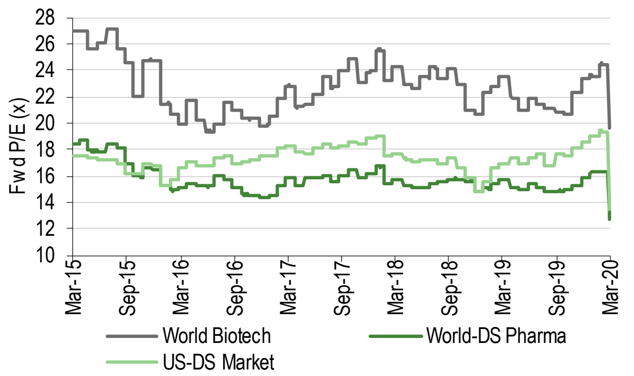
Healthcare is massively in the global spotlight as a result of the COVID-19 pandemic; healthcare investment perhaps less so, as investors flee risk assets in a climate of unprecedented uncertainty. Stock markets (both in biotechnology and healthcare and more generally) have given up more than three years of gains in a matter of weeks (in Swiss franc terms; Exhibit 2, left-hand side), and even a concerted global shift towards significant monetary and fiscal stimulus has so far failed to have much impact on market sentiment. As a result, valuations (Exhibit 2, right-hand side) are also at the bottom end of five-year ranges. However, the fundamentals underpinning healthcare investment remain largely unchanged: a large and ageing global population, now facing an additional threat from coronavirus, 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. While the immediate outlook for any equity investment remains clouded by fear and the likelihood of a severe economic downturn, a fund focused on supporting and reaping the benefits of healthcare innovation could stand investors in good stead over the longer term.

**Exhibit 2: Market performance and valuation**

**Healthcare, biotech and global equity market performance (CHF)**




**Healthcare, biotech and US equity market 12-month forward P/E**




Source: Refinitiv, Edison Investment Research. Note: Data to 24 March 2020.

## Fund profile: Diversified private/public portfolio

Beginning its life in 2001 as HBM BioVentures, HBM Healthcare Investments (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. While more than half of the portfolio is now invested in public equities, many of these companies (including six of the top 10 holdings) originated in the private segment. 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 that 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 six-strong non-executive board (mainly made up of pharmaceutical industry specialists), and the fund management team is led by Chief Executive Officer Andreas Wicki and Chief Financial Officer Erwin Troxler.

## The fund manager: HBM Partners

### The manager's view: Holding up well amid turbulence

We spoke to Mr Wicki and Mr Troxler on 13 March 2020, at the end of one of the worst weeks in global financial markets for many years as the coronavirus disease COVID-19 spread further throughout the world. They say that notwithstanding the headline-grabbing race for a vaccine or cure for the disease, the immediate impact on the healthcare and biotech sector is likely to be twofold. First, ongoing clinical trials in a hospital setting are likely to be suspended, and recruitment for new trials will slow or stop, as hospitals will need their full capacity for accommodating the increased patient load. This could push out timelines for clinical readouts and drug approvals. Secondly, doctors with their hands full dealing with the disease outbreak will have less time or inclination to see drug company representatives, which could slow the pace of new product sales. While a pause of perhaps six months on a trial would have little impact on the clinical outcome, they point out that for companies short on development financing, the delay could mean they need to raise money, which is likely to be done based on lower valuations as a result of the market sell-off.

However, the managers say that HBMN's private portfolio is primarily positioned in mature companies, as part of strong syndicates or with existing partners that have cash to finance immediate needs, so the risk of having to seek third-party financing and incur a material write-down is relatively limited. 'With more than CHF230m in cash, we are sitting comfortably, in a strong position even if markets fall further,' says Troxler.

While HBMN's NAV fell by 12.6% between 15 February and 15 March, this was far less than the 24.2% decline in the MSCI World Health Care Index between these dates (all in Swiss franc terms), despite headwinds from the weakening US dollar. On the public side of the portfolio, performance was helped by the fund's hedges (short positions in S&P Biotech Index ETFs), which the managers have reduced with each leg down in the market, generating cash 'to grab opportunities in public markets when the time is right', while effectively increasing market exposure at lower valuations. Troxler says the high cash balance also means HBMN is very well positioned for paying its dividend, which will be declared with the fund's final FY20 results (to 31 March), due out in May.

The managers say that for the moment they are more on the sidelines when it comes to new private equity investments, as there is often a six- to 12-month time lag before a major public market sell-off is reflected in the private equity sector. 'If markets do not improve, a lot of these businesses may need more financing, which means valuations will come down,' says Troxler, adding that HBMN's strong financial position means it will be well placed to take advantage of the need for new financing at lower prices. 'We are always prudent, so this is an opportunity for companies like us.'

Wicki adds: 'Our positioning of the portfolio, with a private equity portion, and prudence on the public side through the use of hedges, is proof that we can hold up fairly well even in turbulent markets.' He notes that while the share price has suffered more than the NAV in the recent sell-off, it is important to note that in previous times of distress, the discount has been significantly wider. 'A discount represents an additional value opportunity for buyers, especially if the fund pays a dividend,' he concludes.

# Asset allocation

## Investment process: Seeking listed and unlisted opportunities

While it has its roots in private equity investment, HBMN now invests across the spectrum of listed and unlisted companies in the healthcare and biotechnology sectors, as well as in private equity funds. 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. In order 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. 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 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 through the use of hedges in the public portfolio (currently covering c 10%). Positions are continually reviewed, and risk management also includes ongoing monitoring of global markets and macroeconomic developments.

## Recent and expected catalysts

HBMN's managers have provided an update on expected product approvals as detailed in the Q320 quarterly report:

- Y-mAbs Therapeutics is still on track to see two drugs (naxitamab and omburtamab) approved for the treatment of rare cancers in children.
- Viela Bio expects approval for inebilizumab, an antibody to treat neuromyelitis optica spectrum disorder, an inflammatory condition of the central nervous system.
- An antibody-drug conjugate developed by Immunomedics, for the treatment of metastatic triple-negative breast cancer, is still on course to be approved.

- Esperion Therapeutics and Biohaven Pharmaceuticals have received approval respectively for the use of bempedoic acid to treat statin-intolerant patients with high cholesterol levels, and for Nurtec for the acute treatment of migraine.
- Zogenix has had expected approval for its Fintepla drug for Dravet syndrome (a rare and severe type of epilepsy) pushed back from March to June, as the FDA reviews additional data.

In terms of clinical catalysts, in late February, German company Adrenomed reported positive results from its Phase II trial of adrecizumab for the treatment of acute septic shock (the most severe form of sepsis). Biohaven is still expecting Phase III trial data in migraine prevention this quarter, but has missed the primary endpoint in its Phase III trial for a treatment for generalised anxiety disorder. Trial data is still pending for Turning Point Therapeutics (lung cancer, Phase II), Argenx (myasthenia gravis, Phase III) and uniQure (haemophilia B, Phase III). Meanwhile, ChemoCentryx is expected to produce two sets of Phase II trial data, one for avacopan in the treatment of hidradenitis suppurativa, and the other for CCX140 in focal segmental glomerulosclerosis (FSGS). Akebia Therapeutics is also expected to report two sets of trial data for Vadadustat (both Phase III) for its INNO2VATE trial in dialysis-dependent chronic kidney disease (CKD) and its PRO2TECT trial in non-dialysis-dependent CKD. These follow on from successful Phase III trials last year in Japan, where product approval is expected during 2020.

## Current portfolio positioning

At 31 December 2019 (end-Q320), HBMN had 95 disclosed holdings – 31 private companies, 15 private equity funds and 49 listed companies – accounting for c 98% of total assets. Since that date, one private holding (Arcutis Biotherapeutics) has moved to the listed portfolio after IPO, one new private investment (Karius) has been made, and there has been one complete sale (XBiotech). The top 10 holdings – only one of which is not private/ex-private – made up 38.7% of the portfolio at 29 February 2020, a marginal decrease in concentration from 39.3% at 31 March 2019 (end-FY19).

**Exhibit 3: Portfolio positions by therapeutic area (% unless stated)**

| | Portfolio end-February 2020 | Portfolio end-March 2019 | Change (pp) |
|---|---|---|---|
| Oncology | 20.0 | 14.0 | 6.0 |
| Orphan diseases | 13.0 | 23.0 | (10.0) |
| Immunology/inflammation | 13.0 | 7.0 | 6.0 |
| CNS disorders | 13.0 | 9.0 | 4.0 |
| Medtech/diagnostics | 4.0 | 5.0 | (1.0) |
| Digital health | 4.0 | 5.0 | (1.0) |
| Metabolic diseases | 4.0 | 4.0 | 0.0 |
| Infectious diseases | 2.0 | 3.0 | (1.0) |
| Others | 27.0 | 30.0 | (3.0) |
| | **100.0** | **100.0** | |

Source: HBM Healthcare Investments, Edison Investment Research

As shown in Exhibit 3, HBMN's portfolio is well spread by clinical focus. So far in FY20, the proportions in oncology-focused companies and immunology/inflammation have each risen by 6pp, while orphan diseases has fallen by 10pp. Exhibit 4 illustrates that, although almost half the portfolio (including funds) is in unlisted companies, this does not mean they are all early-stage or speculative: 41% of holdings have products already on the market, and only 18% are in the earlier stages of product development (prior to Phase III trials).

The healthcare and biotech sectors tend to be heavily dominated by US-based companies, which make up c 71% of HBMN's portfolio (Exhibit 5). However, the fund also has exposure to the fast-growing Chinese market, both through largest holding Shanghai Cathay Industrial Biotech, and also in its funds portfolio (US dollar denominated) and via some Hong Kong-listed public companies. European companies are also well represented, including top 10 holdings Argenx (a Netherlands-based company focused on autoimmune disorders and cancer) and Swixx Biopharma (a private Swiss company distributing biopharmaceutical products in Central and Eastern Europe).

Shanghai Cathay Industrial Biotech, a manufacturer of biologically based artificial fibres that has been HBMN's largest private holding for some time, has published its IPO prospectus for listing on China's new science and technology-focused STAR market. HBMN's managers say the approval process is proceeding as expected, and the IPO may still go ahead in 2020, given the Chinese economy and stock market are already showing signs of recovery as the rate of coronavirus infection slows. The stock will remain a large position even after IPO, as there is a three-year lock-up in place.

**Exhibit 4: Portfolio breakdown by stage***

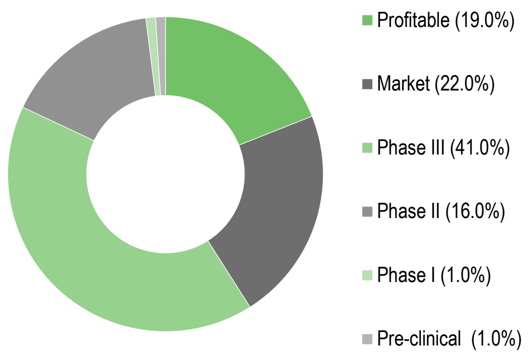
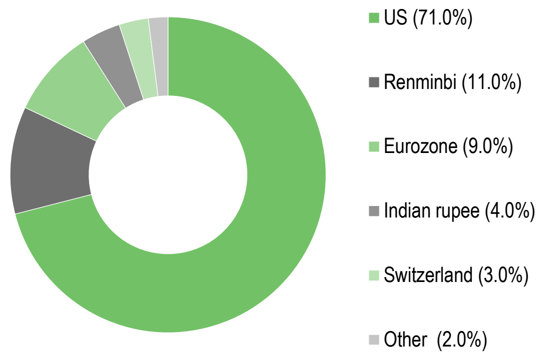



**Exhibit 5: Portfolio breakdown by country/currency**




Source: HBM Healthcare Investments, Edison Investment Research. Note: Data at 29 February 2020. *Classified by most advanced development stage.

Following its successful IPO in February, Arcutis Biotherapeutics is now a top 10 holding. HBMN initially invested $15.0m in the California-based dermatological specialist in a private financing round in October 2019, adding an extra $7.7m on flotation. The share price rose by 28.2% on the first day of trading, and although it fell back in the March sell-off, at 20 March 2020, Arcutis shares stood at $33.20, 95% higher than the $17 issue price.

The newest holding, Karius, is a privately owned diagnostics company in which HBMN invested in a large financing round alongside Japanese technology holding company Softbank in February 2020. Karius has developed a broad-based genomic testing technology to detect and identify pathogens, be they bacteria, viruses or fungi. As Wicki says, 'you can take a very sick patient and literally see what is bugging him'.

Having been cautious with new investments over the first calendar quarter of 2020, HBMN now holds a significant amount of cash that can be deployed when its managers sense a bottoming in the market. They point out that by reducing the hedges on the listed portfolio (via short positions in ETFs tracking the S&P Biotech Index) during March, they have already effectively increased their market exposure.

## Performance: Outperforming in bad times and good

**Exhibit 6: Five-year discrete performance data**

| 12 months ending | Share price (%) | NAV (%) | MSCI World Health Care (%) | NASDAQ Biotech (%) | CBOE UK All Companies (%) |
|---|---|---|---|---|---|
| 29/02/16 | (3.2) | 0.7 | (4.2) | (20.5) | (12.5) |
| 28/02/17 | 19.5 | 16.5 | 11.9 | 18.0 | 11.0 |
| 28/02/18 | 32.9 | 9.4 | 6.0 | 3.7 | 9.1 |
| 28/02/19 | 26.7 | 18.6 | 15.5 | 10.5 | 3.4 |
| 29/02/20 | 38.3 | 24.5 | 3.1 | (1.1) | (8.7) |

Source: Refinitiv. Note: All % on a total return basis in pounds sterling.

HBMN enjoyed a period of particularly strong performance over the 12 months to the end of February 2020, with both the share price and NAV reaching all-time highs during the month.

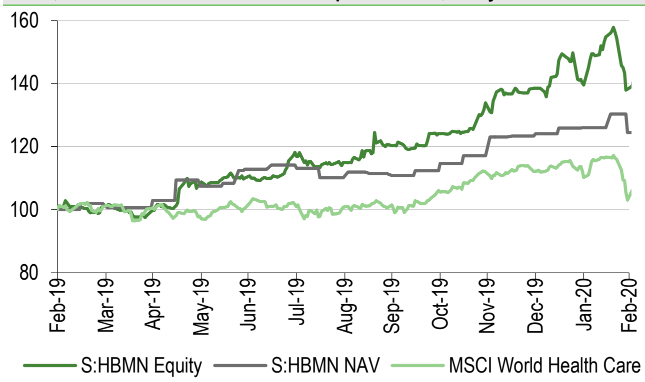
However, the severe global market sell-off caused by the coronavirus pandemic and the oil price war between former OPEC+ allies has undoubtedly had a negative impact, and HBMN's share price and NAV fell by 22.1% and 8.5%, respectively, between 29 February and 16 March, compared with a fall of 14.3% for the MSCI World Health Care Index and 19.2% for the NASDAQ Biotech Index (all in Swiss franc terms). These index performances underline the somewhat defensive nature of the healthcare sector; by way of comparison, the MSCI World Index declined by 22.2% between these dates, and the CBOE UK All Companies Index by 27.4%.

In NAV terms, HBMN's performance tends to be less volatile in part because of its unlisted exposure (c 41% of the portfolio at end-February), where most individual holdings are valued conservatively at book cost. The fund's equity market hedges (c 18% of public equity exposure was hedged at end-February) have also proved beneficial, and the managers have reduced them (to c 10% of the portfolio at mid-March) as markets have fallen, generating cash proceeds of c CHF45m. The deliberately high cash balance (CHF220m at end-February, or 14% of total assets) has provided a further buffer in the recent sell-off.

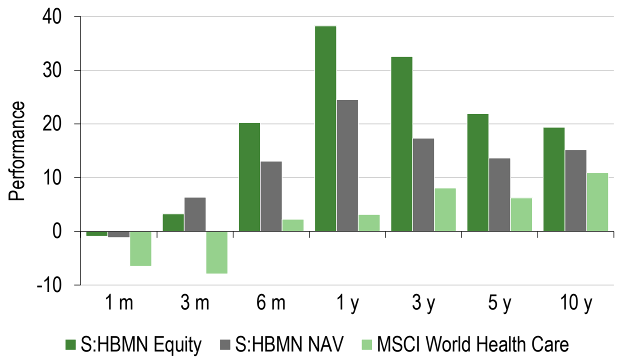
While it is tempting in the midst of a market panic to focus on the very short term, it is important to remember that investment is a long-term endeavour, particularly in areas such as healthcare and biotechnology, where new product development can take many years. As shown in Exhibit 7, HBMN has substantially outperformed the MSCI World Health Care Index over all periods shown (in Swiss franc, to end-February) in both NAV and share price total return terms. It has also outperformed the NASDAQ Biotechnology Index over three, six and 12 months and three, five and 10 years (Exhibit 8), and is materially ahead of the broad UK equity market over all periods under consideration.

**Exhibit 7: Investment company performance to 29 February 2020**

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

| | One month | Three months | Six months | One year | Three years | Five years | 10 years |
|---|---|---|---|---|---|---|---|
| Price relative to MSCI World Health Care | 6.0 | 12.2 | 17.6 | 34.1 | 84.5 | 99.0 | 108.3 |
| NAV relative to MSCI World Health Care | 5.7 | 15.5 | 10.6 | 20.8 | 28.0 | 40.1 | 46.7 |
| Price relative to NASDAQ Biotech | (1.6) | 11.5 | 10.6 | 39.9 | 105.7 | 153.7 | 53.7 |
| NAV relative to NASDAQ Biotech | (1.9) | 14.9 | 4.0 | 25.9 | 42.7 | 78.7 | 8.2 |
| Price relative to CBOE UK All Companies | 12.2 | 19.3 | 24.3 | 51.4 | 126.0 | 168.9 | 300.2 |
| NAV relative to CBOE UK All Companies | 11.9 | 22.9 | 16.9 | 36.3 | 56.9 | 89.3 | 181.8 |

Source: Refinitiv, Edison Investment Research. Note: Data to end-February 2020. Geometric calculation.

Drivers of the strong recent performance include a number of successful IPOs of portfolio holdings over the past 12 months, most recently Arcutis Biotherapeutics, which debuted on the NASDAQ market on 31 January. As shown in Exhibit 9, the five companies that came to market since April 2019 had seen their share prices rise by an average of 98.2% to end-February, although all subsequently experienced double-digit declines. HBMN's approach to IPOs from its private portfolio tends to be to invest additional funds at the flotation, and then realise some of the gain if the shares perform strongly, reducing the position back towards its original level. The fund has also benefited recently from taking profits in some strongly performing listed holdings, locking in gains before the market sentiment began to turn.

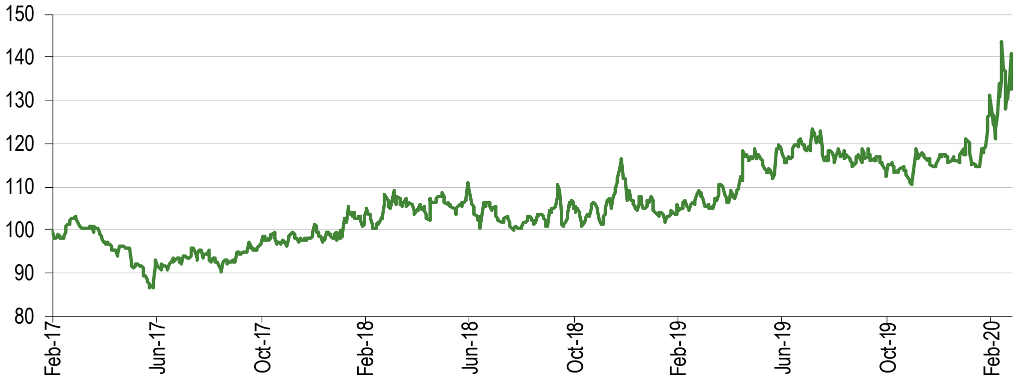
**Exhibit 9: Performance of last five IPOs from HBMN's private portfolio**

| Company | IPO year | US$m invested* | Post-IPO performance** |
|---|---|---|---|
| Arcutis Biotherapeutics | 2020 | 22.6 | 57.3% |
| Galera Therapeutics | 2019 | 6.5 | 43.3% |
| Viela Bio | 2019 | 29.5 | 115.4% |
| SpringWorks Therapeutics | 2019 | 15.2 | 85.3% |
| Turning Point Therapeutics | 2019 | 14.5 | 189.7% |

Source: HBM Healthcare Investments, Edison Investment Research. Note: *Includes money invested privately and at IPO. **Performance from IPO until 28 February 2020.

HBMN's managers are seeing opportunities as a result of falling share prices in stocks such as Y-mAbs Therapeutics (another name originally from the private portfolio, but now the fund's largest listed holding) and XBiotech (a position sold in February after its sale of an asset to Johnson & Johnson). Wicki notes that Y-mAbs has fallen dramatically on the back of low trading volumes but without any negative newsflow: 'it still has two products coming to market this year and is now ridiculously undervalued'. In the case of XBiotech, he says that it may once again look attractive on a long-term basis, having fallen by more than 50% compared with HBMN's exit price, to the point where it is now trading below the value of its cash.

**Exhibit 10: NAV total return performance relative to benchmark over three years**




Source: Refinitiv, Edison Investment Research. Note: Data to 20 March 2020.

## Discount: Fall from premium proves attractive to some

**Exhibit 11 Share price premium/discount to NAV (including income) over three years (%)**


Source: Refinitiv, Edison Investment Research

At 24 March 2020, HBMN's shares traded at a 15.4% discount to NAV. Having followed a narrowing trend for the past three years (Exhibit 11, reaching a 10-year high premium of 11.1% in mid-February, the discount has been more volatile in the recent market sell-off, partly due to the fact the fund only publishes its NAV fortnightly. So far this month (based on the published 15 March NAV), the share price has fallen by 23.0% and the NAV by 8.5%, although the worst of the share price falls had occurred prior to the latest NAV being published, leading the shares to de-rate from a 3.7% premium at 3 March to a discount of 20.1% (a 12-month high) at 12 March (in both cases based on the 29 February NAV). HBMN's managers report a good level of liquidity in the shares during the current spell of market volatility, with buying activity from investors that may have been 'on the sidelines' waiting for the premium to reduce.

## Capital structure and fees

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. 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. HBMN is geared via two bond tranches of CHF50m each (equating to c 6.5% of net assets), maturing in 2021 and 2023. However, at 29 February 2020, the gearing (and the cost of market hedges) was more than offset by cash and equivalents, and HBMN had a net cash position of 6.2% (CHF95m).

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 the last four reported quarter-ends (to 31 December 2019), we calculate ongoing charges at 1.34% (FY19: 1.41%). 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 (CHF31.9m) was last paid in respect of FY19, when the pre-performance fee NAV per share at the year-end was CHF194.36. Although we are close to the year-end and the last reported NAV was 4.0% above the high-water mark (CHF202.21 per share at 15 March), given the current market volatility, it is hard to say with certainty that a performance fee will be earned in respect of FY20.

## Dividend policy and record

In 2013, HBMN implemented a high distribution policy, recognising the attractiveness to shareholders of investment income in an environment of historically low interest rates. The policy states that investors will receive cash distributions of c 3–5% of NAV each year, which may be supplemented by share buybacks up to a combined total of c 8% of NAV. The cash distribution was paid out of capital reserves prior to FY18; it is now paid as a par value repayment (which is more tax-efficient for HBMN than transferring part of the par value into reserves and then paying it out). As part of this move (with FY18 being a transitional period when the payment was made in two stages), the distribution is now paid in September rather than June. The FY19 total distribution of CHF7.50 was 7.1% higher year-on-year, and distributions have grown at a five-year compound annual rate of 20.1%. The FY19 payment represented a 4.4% distribution yield on the year-end share price of CHF168.80; in previous years the distribution yield had been closer to 5.0%. Based on the current share price and the FY19 distribution, HBMN's shares currently yield 4.4%.

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## Peer group comparison

Below in Exhibit 12 we present HBMN's performance alongside its Switzerland-listed peer BB Biotech, and the members of the Association of Investment Companies' Biotechnology & Healthcare sector. In a period of significant market volatility, HBMN is the only fund to have produced a positive NAV total return over one year to 19 March, with most peers posting double-digit declines. It is also well above average over three, five and 10 years, ranking second, first and second, respectively. Ongoing charges are among the highest and HBMN may incur a performance fee; however, it is worth noting that performance figures are net of fees. In spite of its recent NAV outperformance, HBMN stands at the widest discount to NAV in the group. It is ungeared on a net basis, and has an above-average dividend yield, ranking third in the peer group.

**Exhibit 12 Selected peer group as at 20 March 2020, 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 | Discount (cum-fair) | Net gearing | Dividend yield |
|---|---|---|---|---|---|---|---|---|---|---|
| **HBM Healthcare Investments** | **1,153.5** | **11.8** | **45.1** | **69.8** | **283.8** | **1.41** | **Yes** | **(18.0)** | **100** | **4.5** |
| BB Biotech | 3,044.2 | (28.7) | (12.5) | (15.8) | 324.4 | 1.26 | No | 21.4 | 109 | 6.2 |
| BB Healthcare | 651.7 | (23.5) | 7.1 | -- | -- | 1.16 | No | 8.9 | 106 | 3.8 |
| Biotech Growth Trust | 348.7 | (2.7) | 1.4 | (21.3) | 239.9 | 1.05 | Yes | (11.8) | 111 | 0.0 |
| International Biotechnology Trust | 224.0 | (13.0) | (2.4) | (14.0) | 189.4 | 1.27 | Yes | (15.2) | 100 | 4.8 |
| Polar Capital Global Healthcare | 252.1 | (19.7) | (6.3) | (9.9) | -- | 1.13 | Yes | (12.1) | 110 | 1.1 |
| Syncona | 1,476.8 | (10.5) | 46.6 | 39.6 | -- | 1.83 | No | (3.3) | 100 | 1.1 |
| Worldwide Healthcare Trust | 1,498.4 | (16.0) | 4.8 | 2.7 | 188.1 | 0.90 | Yes | (7.5) | 108 | 1.0 |
| **Sector average (8 funds)** | **1,081.2** | **(12.8)** | **10.5** | **7.3** | **245.1** | **1.25** | | **(4.7)** | **106** | **2.8** |
| **HBMN rank in sector** | **4** | **1** | **2** | **1** | **2** | **2** | | **8** | **6** | **3** |

Source: Morningstar, Edison Investment Research. Note: *Performance to 19 March 2020 based on ex-par NAV. TR=total return. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared).

## The board

HBMN has six independent, non-executive directors on its board. Hans Peter Hasler, the chairman, has served on the board since 2009. Vice-chairman Professor Heinz Riesenhuber (a retired German MP) is the longest-serving director, having been on the board since launch in 2001. The other directors and their years of appointment are Dr Rudolf Lanz (2003), Robert A Ingram (2006), Dr Eduard E Holdener (2008) and Mario G Giuliani (2012). Most of the board members have worked professionally in the biotechnology and life sciences sectors. Each director has specific responsibilities regarding the monitoring of HBMN's portfolio and the wider market environment. Mr Hasler and Mr Ingram cover regulatory (FDA) approval and sector and marketing strategies; Professor Riesenhuber and Mr Giuliani monitor management, production and audit; Dr Lanz (a lawyer and corporate financier) also covers audit, as well as finance and M&A transactions; and Dr Holdener assesses research and development.

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