

## BB Biotech

High-conviction specialist with impressive record

**BB Biotech (BION) is a long-established (since 1993), Switzerland-based global investor in the innovative area of biotechnology. It is differentiated from peers by its short list of stocks (typically 30-35) and high-conviction approach, with five to eight core holdings accounting for half to two-thirds of the portfolio. While the fund can be vulnerable to short-term sentiment dips (such as in the period immediately before and after the US presidential election in 2016), its performance record is impressive in both absolute and relative terms, with a NAV total return of c 270% over five years, and NAV and share price outperformance of the benchmark NASDAQ Biotechnology index over three, six and 12 months, and three, five and 10 years to 31 October 2017 (all in Swiss franc terms). A high distribution policy of 5.0% underpins the current dividend yield of 4.3%.**

12 months ending	Share price (%)	NAV (%)	NASDAQ Biotechnology (%)	MSCI World Healthcare (%)	FTSE All-Share (%)
31/10/13	57.0	63.8	51.9	28.6	19.1
31/10/14	56.4	70.8	54.2	31.6	6.9
31/10/15	42.3	26.9	12.9	9.4	1.8
31/10/16	(11.0)	(26.9)	(20.8)	(6.8)	(11.0)
31/10/17	42.6	43.4	24.2	20.8	24.3

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

### Investment strategy: Concentrated biotech portfolio

BION is managed by a six-strong team with various medical specialisations. They build the high-conviction portfolio of 20-35 stocks (typically 30-35) by filtering a global universe of c 800 companies, looking at industry dynamics, clinical developments, management strength, company financials and return potential. The portfolio is global and diversified by market cap, although there is a preference for companies that are already generating above-average sales and profits.

Concentration in the portfolio is high, with five to eight core holdings accounting for c 50-65% of assets.

### Market outlook: Valuations higher after bull run

Global stock markets have performed strongly in 2017, although there are signs of waning investor enthusiasm as the year draws to a close. Biotech and healthcare stocks have a long record of outperforming mainstream markets, and a recent rise in the average forward P/E valuation in some areas means investors may need to work a little harder to identify stocks that are attractively valued. In the highly specialist area of biotechnology; a detailed understanding of clinical factors is key.

### Valuation: Attractive yield underpins small premium

At 22 November 2017, BION's shares traded at a 0.4% premium to cum-income net asset value. While average discounts on biotech and healthcare peers have recently narrowed to a similar slight premium, BION's discount has been below c 6% for some time, arguably as a result of the attractive yield it offers (4.3% at 22 November) because of its 5% capital distribution policy. The current small premium compares with average discounts of 3.2%, 9.7%, 14.6% and 17.4% over the last one, three, five and 10 years.

### Investment companies

23 November 2017

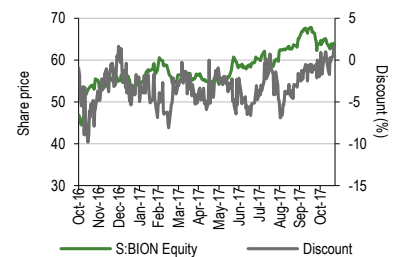
**Price** CHF63.50  
**Market cap** CHF3,515.1m  
**AUM** CHF3,501.3m

NAV\* CHF63.20  
 Premium to NAV 0.4%

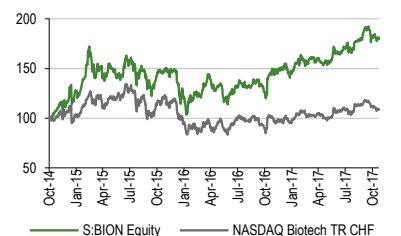
\*Including income. As at 22 November 2017.

Yield (based on FY16 dividend) 4.3%  
 Ordinary shares in issue 55.4m  
 Code BION  
 Primary exchange Zurich  
 AIC sector N/A  
 Benchmark NASDAQ Biotechnology

### Share price/discount performance



### Three-year performance vs index



52-week high/low CHF67.80 CHF52.10  
 NAV\* high/low CHF68.50 CHF54.20

\*Including income.

### Gearing

Gross\* 4.1%  
 Net\* 3.2%

\*As at 30 September 2017.

### Analysts

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### Exhibit 1: Company at a glance

#### Investment objective and fund background

BB Biotech (BION) is a Switzerland-domiciled investment company, targeting long-term capital growth from biotechnology companies that are developing and marketing innovative drugs. At least 90% (currently 100%) of the portfolio is invested in listed companies, primarily mid-cap names that are already profitable. It is benchmarked against the NASDAQ Biotechnology index, but is managed bottom-up with a concentrated 20-35 stock portfolio.

#### Recent developments

- 20 October 2017: Results for the quarter ended 30 September. Share price +10.7% in CHF, 6.4% in € and 9.6% in US\$. NAV +11.0% in CHF, 6.2% in € and 9.8% in US\$ versus NASDAQ Biotech index +7.7% in US\$.
- 21 July 2017: Results for the six months ended 30 June. Share price total return of 12.2% in CHF, 8.8% in € and 19.4% in US\$. NAV total returns of 16.1% in CHF, 13.1% in € and 23.5% in US\$. Includes dividend of CHF2.75.

#### Forthcoming

AGM	March 2018
Annual results	February 2018
Year end	31 December
Dividend paid	March (part capital return)
Launch date	November 1993
Continuation vote	None

#### Capital structure

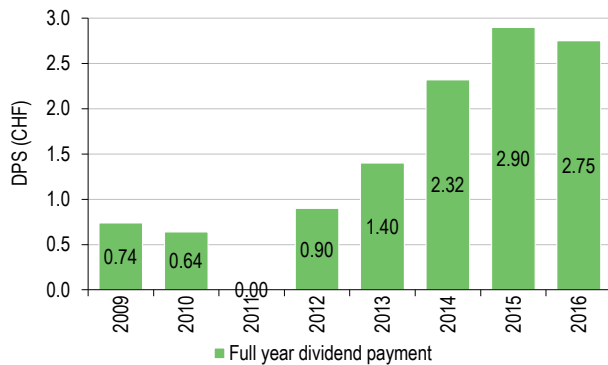
Ongoing charges	1.23% (30 September)
Net gearing	3.2% (30 September)
Annual mgmt fee	1.1% on market cap
Performance fee	None
Trust life	Indefinite
Loan facilities	See page 7

#### Fund details

Group	Bellevue Asset Management
Manager	Team-managed
Address	Seestrasse 16, 8700 Küsnacht, Switzerland
Phone	+41 (0)44 267 6700
Website	<a href="http://www.bbbiotech.com">www.bbbiotech.com</a>

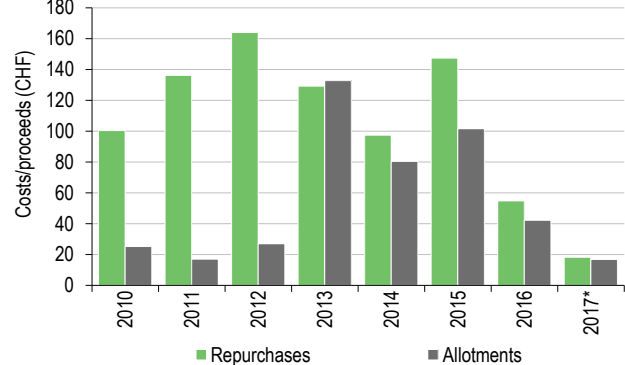
#### Dividend policy and history (financial years)

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 volume-weighted average December share price. Dividends restated to take account of five-for-one stock split in March 2016.

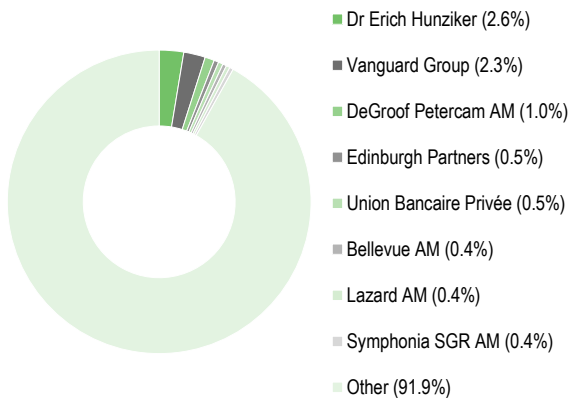


#### Share buyback policy and history (financial years)

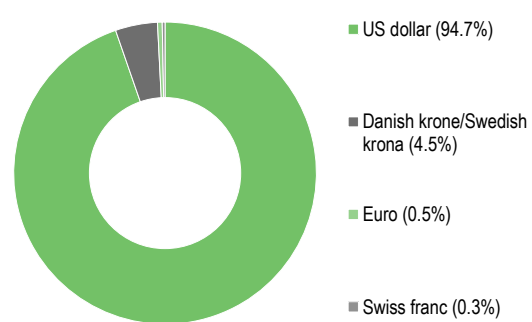
BION has the authority, renewed annually, to repurchase up to 10% of its issued share capital. As part of the distribution policy announced in 2012, BION has also committed to returning 5% of its share price at the year-end via the share buyback process during the year. \*Up to 30 September 2017.



#### Shareholder base (as at 31 October 2017)



#### Portfolio exposure by currency (as at 30 September 2017)



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

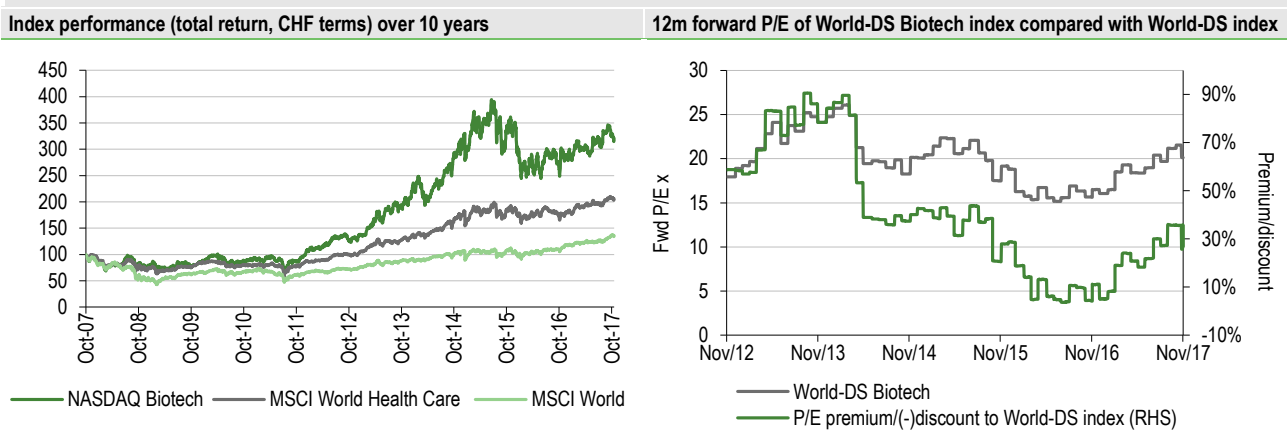
Company	Country	Main clinical focus	Portfolio weight %	
			30 September 2017	30 September 2016
Celgene	US	Oncology	12.2	10.8
Incyte	US	Oncology	11.2	11.0
Ionis Pharmaceuticals	US	Genetic diseases	10.4	7.9
Gilead	US	Infectious diseases	5.9	6.6
Vertex Pharmaceuticals	US	Orphan diseases	5.9	3.7
Neurocrine Biosciences	US	Women's health	5.6	4.7
Radius Health	US	Women's health	5.6	7.1
Alexion Pharmaceuticals	US	Orphan diseases	5.0	4.3
Agios Pharmaceuticals	US	Oncology	4.8	4.2
Novo Nordisk	Denmark	Metabolic diseases	4.0	3.7
<b>Top 10 (% of portfolio)</b>			<b>70.6</b>	<b>68.6</b>

Source: BB Biotech, Edison Investment Research, Bloomberg, Morningstar, Ipreo.

## Market outlook: Fundamentals underpin strong returns

As shown in Exhibit 2 below (left-hand chart), biotechnology stocks have significantly outperformed the broader global healthcare market, which has in turn markedly outperformed the MSCI World index (all figures in Swiss francs) over the past 10 years. Favourable fundamentals underpinning the rise in healthcare and biotech stocks include the increased pace of clinical and technological advances, better understanding of disease processes, ageing populations worldwide (older people tend to have greater healthcare needs) and increasing affluence in developing countries. However, valuations of biotech stocks have also increased recently (right-hand chart) from low levels, with the 12-month forward P/E ratio for the World Datastream Biotech index now broadly in line with the five-year average (at 20.1x versus an average of 19.9x. While the average P/E of biotech stocks is above that of the broad World-DS index, the 26.8% premium at 15 November 2017 was well below the five-year average premium of 40.5%.

**Exhibit 2: Market performance and valuation**



Source: Thomson Datastream, Edison Investment Research

## Fund profile: Established biotech specialist

BB Biotech (BION) is a Switzerland-based specialist biotechnology fund, launched in 1993, which aims to generate capital growth by investing in a concentrated portfolio of innovative biotech companies, with a bias towards fast-growing smaller and mid-cap names. It has a primary listing on the Swiss SIX exchange as well as euro-denominated secondary listings in Germany and Italy. Since 2015, its inclusion in the Stoxx 600 index has boosted liquidity, and because it is listed on a recognised European exchange, BION may be held in an ISA by UK investors.

The portfolio contains 20-35 stocks (usually 30-35), with five to eight core holdings (currently seven) accounting for around half to two-thirds of the total. The management team prefers companies that already have products on the market and are profitable, although BION does have small positions in some earlier-stage companies that may offer significant future profit potential. Up to 10% (currently zero) may be invested in unquoted companies. The fund uses the NASDAQ Biotechnology index as a performance benchmark, although its short stock list and tilt towards mid-cap companies means there is limited overlap with the index, and performance has tended to diverge quite widely from the benchmark.

BION is managed by Bellevue Asset Management, a healthcare specialist headquartered in Küsnacht, Switzerland, with portfolio managers in Zurich and New York, and an executive board of industry experts overseeing major investment decisions.

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## The fund manager: Bellevue Asset Management

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### The manager's view: Expecting a rapid rise in revenues

BION's managers argue that there is still value to be found across biotech sectors, in spite of recent increases in valuations in certain areas. Team head Dr Daniel Koller says that large-cap biotech stock valuations are still very reasonable, with median forward P/E ratios of 13-15x, although the median forward P/E valuation of seven major biotech mid-caps is now above 30x for 2018, 2019 and 2020. However, Bellevue's models predict a rapid acceleration in revenues for portfolio companies from 2018, backed by a strong pace of expected product approvals, including two each for core holdings Ionis, Gilead and Vertex. If the expected rise in earnings comes through, stocks may begin to look cheaper on a P/E basis.

Koller explains that the team takes a slightly different approach with large companies than with mid-caps, based on an S-curve model that demonstrates slowing growth as companies mature. Large-caps in the portfolio have generally been owned since they were at a much earlier stage, and the managers may lock in profits by trimming positions when prices are high. Mid-caps may be more actively traded; Koller says the backdrop of higher valuations supports a patient and opportunistic approach, allowing the managers to buy favoured stocks on dips caused by sentiment or newsflow.

An evolution in the approach of the key regulator, the US Food & Drug Administration (FDA), since the appointment of new head Dr Scott Gottlieb earlier this year, has arguably provided such opportunities. In a move towards greater transparency, the FDA is publishing reports of drug risks and side-effects on its website, but as these disclosures may be hard for non-specialist investors to put into context, they can cause share prices to dip, providing a potential entry point for investors with a better understanding of the clinical background. Koller notes that under Gottlieb, the FDA is also targeting quicker turnarounds for drug assessments, thus accelerating the pace of approvals.

The manager highlights some strong performers this year among stocks outside the core holdings, including Esperion (up 270% year-to-date but still c 60% off its all-time high, leaving plenty of room for improvement), Juno (which found favour with investors because of similarities with Gilead bid target Kite and is up 206% ytd) and Alnylam (up c 200% ytd after positive trial results for patisiran).

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## Asset allocation

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### Investment process: Combining clinical and profit potential

BION's six-strong portfolio management team is led by Dr Daniel Koller. The members of the team have a variety of medical specialisations. The managers monitor medical journals, attend industry conferences and meet physicians, specialists and biotech company management teams, allowing them to assess biotech innovations and developing industry themes. Starting with a global universe of c 800 established and developing biotech companies, the team filters the opportunity set to c 300-400 companies by focusing on indications or diseases where scientific or technological advances coincide with strong market potential. Qualitative and quantitative tests further narrow down the universe to a 'long list' of c 150 potential investments.

For each candidate stock, the managers assess factors such as innovation, intellectual property ownership (there is a strong preference for 'unencumbered' assets where the intellectual property is wholly owned), quality of management and pharmacoeconomics, as well as building detailed financial models. Screening criteria are weighted towards clinical factors, although the team prefers to invest in companies that have the potential to generate above-average sales and profits growth.

The output of this analysis is an investment proposal, including clinical data, financial models, an estimate of potential upside and downside, and recommendations on position size and purchase

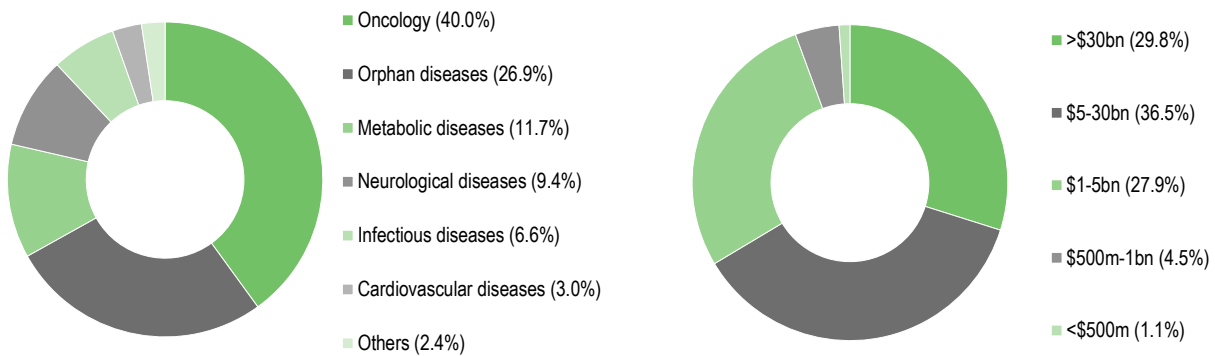
price. After discussion within the team, the proposals are presented to the executive board, whose members have final sign-off on new positions, complete exits and major changes in weighting.

New positions are usually sized at 0.5-4.0% of the portfolio, with earlier-stage companies tending to come in at the smaller end of the range. The final portfolio has 20-35 stocks (usually c 30-35), drawn from around the world and across the size spectrum, although the majority of investments are listed in the US, as this is where the largest number of biotech companies are to be found. Five to eight core holdings account for around half to two-thirds of the portfolio. Holdings may be trimmed to keep positions from getting too large, and may be sold completely if they reach valuation targets, or if poor clinical data or regulatory setbacks call the original investment thesis into question.

### Current portfolio positioning

At 30 September 2017, there were 31 companies in BION’s portfolio, compared with 33 at the same time in 2016. The top 10 holdings made up 70.6% of the portfolio by value, compared with 68.6% a year previously. BION’s strategy is to have five to eight ‘core’ holdings as part of the 20- to 35-stock portfolio. Currently, there are seven core holdings (Celgene, Incyte, Ionis Pharmaceuticals, Gilead, Vertex Pharmaceuticals, Neurocrine Biosciences and Radius Health), compared with six at 30 September 2016. Together, these make up 56.8% of the portfolio.

**Exhibit 3: Portfolio distribution by clinical focus (left) and market capitalisation (right)**



Source: BB Biotech, Edison Investment Research. Note: as at 30 September 2017.

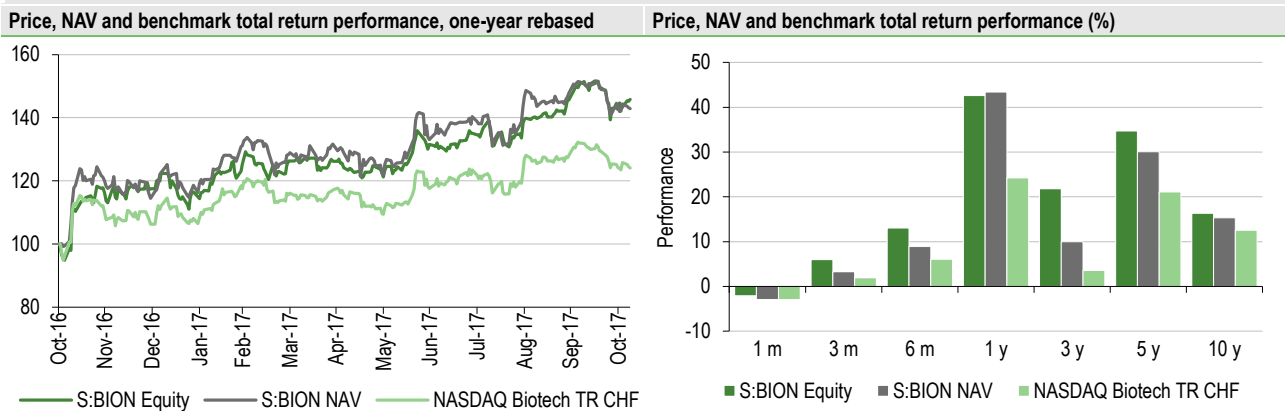
In terms of clinical focus, the largest exposure is to oncology (Exhibit 3, left-hand chart). Orphan diseases has seen the biggest increase over 12 months, up 9.7pp to 26.9% of the portfolio. The biggest decreases in exposure over 12 months are cardiovascular diseases and infectious diseases, down 5.9pp and 6.2pp, respectively, since 30 September 2016. A key part of BION’s strategy is to invest in mid-cap companies, and at 30 September 2017, there was a broadly even split between mega-caps (29.8%), mid- to large-caps (36.5%) and small- to mid-caps (33.5%).

There are three new investments in the portfolio compared with a year ago. Idorsia (a small position at 0.3%) is a research and development (R&D) spinout resulting from the takeover of long-term holding Actelion by Johnson & Johnson in early 2017. Myovant, a specialist in women’s health and prostate cancer, was bought at IPO in Q416, while early-stage oncology specialist Five Prime Therapeutics was added in Q117. Koller comments that it is unusual for the team to invest before Phase II data (due in 2018), but they believe the company has an attractive platform, and they were able to buy during a period of share price weakness.

There have been five exits from the portfolio compared with a year ago – core holding Actelion, Kite Pharma (sold in Q317 following an agreed takeover bid from Gilead), Cempra (sold in Q416 after disappointing toxicity reports for its lead antibiotic candidate), PTC Therapeutics and Puma Biotechnology, which were both sold in Q217 after reaching valuation targets. The position in long-term holding Swedish Orphan Biovitrum has been substantially reduced.

## Performance: Strong absolute and relative record

**Exhibit 4: Investment company performance (in CHF terms) to 31 October 2017**



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

BION's absolute and relative returns have been very strong over the medium to long term. Over 12 months to 31 October it has produced NAV and share price total returns of c 40% versus c 24% for the NASDAQ Biotechnology index, while over five years NAV and share price total returns have averaged c 30-35% a year (Exhibit 4). Returns over three and 10 years are less arresting but are still well ahead of the benchmark, as well as the broader MSCI World Health Care index (Exhibit 5; all returns are in CHF). The strong 12-month performance has come in spite of a significant correction in largest holding Celgene (-30.8% in USD terms in September 2017 alone), with Vertex, Neurocrine Biosciences, Novo Nordisk and Sage Pharmaceuticals all up by more than 30% in US dollar terms over 12 months to mid-November.

While BION underperformed the NASDAQ Biotechnology index in the market corrections of January and October 2016, its long-term performance record versus the index has been positive, with the past 12 months in particular showing steady and sustained outperformance (Exhibit 6).

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

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to NASDAQ Biotechnology	0.9	4.0	6.6	14.8	62.6	70.5	39.4
NAV relative to NASDAQ Biotechnology	0.0	1.4	2.7	15.4	19.8	43.1	27.5
Price relative to MSCI World Health Care	(3.7)	1.5	6.2	18.1	46.7	112.8	119.8
NAV relative to MSCI World Health Care	(4.5)	(1.1)	2.3	18.7	8.1	78.6	101.0
Price relative to FTSE All-Share	(5.7)	(1.0)	3.8	14.7	60.3	209.3	382.6
NAV relative to FTSE All-Share	(6.5)	(3.5)	0.1	15.3	18.1	159.6	341.5

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-October 2017. Geometric calculation.

**Exhibit 6: NAV total return performance relative to benchmark (in CHF) over five years**



Source: Thomson Datastream, Edison Investment Research

## Discount: Near the top of a tight trading range

At 22 November 2017, BION's shares traded at a 0.4% premium to cum-income NAV. Following a substantial narrowing from mid-2015 onwards, the average discount over one year is now 3.2%, compared with three-, five- and 10-year averages of 9.7%, 14.6% and 17.4%. Although the discount reached c 10% in the immediate aftermath of the US presidential election in November 2016, it has rarely been wider than 6% since then. Discounts on all healthcare trusts have recently narrowed, with the established members of the AIC specialist Biotech & Healthcare sector (excluding Syncona) standing at an average premium of 0.7% at 20 November 2017. However, the narrowing of BION's discount pre-dates this recent move, and arguably reflects the attractions of its high distribution policy as well as its strong performance record.

**Exhibit 7: Share price premium/discount to NAV (including income) over three years (%)**



Source: Thomson Datastream, Edison Investment Research

## Capital structure and fees

BION is a closed-ended investment company with a primary listing on the SIX Swiss exchange and euro-denominated secondary listings in Germany and Italy. There are currently 55.4m shares in issue. Gearing is available via a short-term bank loan, of which CHF15m (equivalent to 4.1% of net assets) was drawn at 30 September 2017.

Bellevue Asset Management is paid an all-in management fee of 1.1% of average market capitalisation, with no performance fees. The stated total expense ratio at 30 September 2017 was 1.23% (FY16: 1.28%).

## Dividend policy and record

Biotechnology is not a high-yielding sector, given the early stage of many companies and the capital intensity of developing new treatments; the NASDAQ Biotechnology index has an estimated dividend yield of 0.49% for 2017. However, in recognition of the demand for income from investors, and as part of its discount management policy, BION seeks to make an annual capital distribution equal to 5% of its market capitalisation (based on the volume-weighted average share price in December). In respect of FY16, a distribution of CHF2.75 per share was paid in March 2017, a slight fall from the equivalent figure of CHF2.90 (adjusted for a five-for-one share split) for FY15. Because it is set as a percentage of market cap, the amount of the distribution may fall as well as rise; however, since the current distribution policy was introduced at the end of FY12, the distribution has grown at a compound annual rate of 32.2%. Based on the FY16 distribution and the 22 November share price, BION currently has a dividend yield of 4.3%.

## Peer group comparison

Exhibit 8 below shows the AIC specialist Biotech & Healthcare sector along with BION and HBM Healthcare Investments, also listed in Switzerland. The peer group contains three specialist biotech funds and four broader healthcare funds, as well as Syncona (recently reclassified from the Flexible Investment sector), which invests in life science companies as well as holding a portfolio of non-healthcare funds. The group is presented in Swiss franc terms. BION is the largest fund by some margin. It ranks first for NAV total return performance over five and 10 years, second over three years and third over one year. Ongoing charges are below average and there is no performance fee. BION's modest level of gearing is slightly below the peer group average, it trades at a small premium to NAV, and its dividend yield is the second-highest in the group.

**Exhibit 8: Biotech and healthcare peer group (in CHF terms) as at 20 November 2017\***

% unless stated	Market cap CHFm	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Ongoing charge	Perf. fee	Discount (ex-par)	Net gearing	Dividend yield (%)
<b>BB Biotech</b>	<b>3,753.5</b>	<b>17.4</b>	<b>33.2</b>	<b>271.4</b>	<b>362.9</b>	<b>1.1</b>	<b>No</b>	<b>0.5</b>	<b>103</b>	<b>4.3</b>
BB Healthcare	399.0	--	--	--	--	1.0	No	3.0	103	0.0
Biotech Growth	575.4	8.8	7.3	148.5	295.5	1.1	Yes	(0.4)	110	0.0
HBM Healthcare Investments	962.5	15.6	39.8	210.0	--	1.7	Yes	(19.7)	100	4.6
International Biotechnology Trust	293.4	5.2	22.5	138.7	155.7	0.9	Yes	(0.3)	100	3.9
Polar Capital Global Healthcare	325.5	8.3	9.1	68.0	--	1.1	Yes	(0.3)	100	2.1
Syncona	1,601.3	31.3	24.7	53.6	--	1.5	No	17.8	100	1.2
Worldwide Healthcare Trust	1,590.6	22.7	31.7	163.5	208.2	0.9	Yes	1.3	111	0.9
<b>Weighted average</b>		<b>19.3</b>	<b>29.3</b>	<b>188.4</b>	<b>307.3</b>	<b>1.2</b>		<b>1.5</b>	<b>104</b>	<b>3.0</b>
<b>BION rank in peer group</b>	<b>1</b>	<b>3</b>	<b>2</b>	<b>1</b>	<b>1</b>	<b>3</b>		<b>4</b>	<b>3</b>	<b>2</b>

Source: Morningstar, Edison Investment Research. Note: \*Performance to 16 November 2017. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared).

## The board

BION has an executive board of three directors, all of whom are highly qualified industry experts. Chairman (since 2013) Dr Erich Hunziker is a former CFO of Roche and has served on the BION board since 2011. Dr Clive Meanwell, founder and CEO of The Medicines Company, has been a director of BION since 2003. Professor Dr Klaus Strein held senior R&D roles at Roche and Boehringer Mannheim before joining the BION board in 2013. While day-to-day portfolio management is Bellevue's responsibility, the directors sign off on all major investment decisions.

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