

# BB Biotech

## RNA focus provides a possible COVID-19 solution

BB Biotech (BION) recently updated the market on its views on the COVID-19 pandemic and how they are reflected in its portfolio (see video link below and the [investor update](#)). While direct exposure to infectious disease specialists in the portfolio is low, lead manager Daniel Koller expects a promising vaccine candidate could arise from one of the fund's holdings in companies with RNA-based technologies (five RNA medicine-focused positions make up c 25% of the portfolio). The BION team recently finished an 18-month process of rebalancing the portfolio towards promising small and mid-cap companies to drive future growth. While this has proved a headwind for recent performance, over the long term BION has produced double-digit annual total returns in both share price and NAV terms.

### Webcast: BB Biotech's coronavirus update



Source: BB Biotech

## The market opportunity

The healthcare industry is underpinned by positive fundamentals in terms of ageing populations, increasing prosperity, scientific advances and a helpful regulatory backdrop. However, all eyes are on the COVID-19 pandemic, both for its impact on the global population, economy and corporate earnings and in the race for reliable large-scale testing, vaccines and a possible cure. While further volatility is likely in the near term, exposure to the sector could benefit long-term investors.

## Why consider investing in BB Biotech?

- Long-term track record of outperformance, targeting 15% pa compound growth.
- High distribution policy, paying out 5% of average December share price.
- Highly experienced management team and board, with strong scientific and medical credentials, seeking tomorrow's winning treatments.
- Small- and mid-cap focus and concentrated portfolio (maximum 35 stocks) allow for meaningfully differentiated returns.

## Back at a premium and committed to distributions

At 14 April 2020, BION's shares traded at a 14.8% premium to NAV. This is higher than the one-year average premium of 12.0%, but below the 10-year high of 24.5% seen in mid-March, and suggests there are still willing buyers in the market despite the volatile conditions. The board has reaffirmed its commitment to the 5% distribution policy and a dividend of CHF3.40 was paid in March 2020 for FY19.

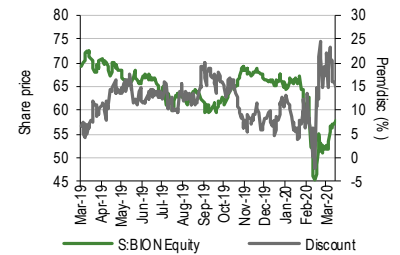
### Investment companies Biotech and healthcare

16 April 2020

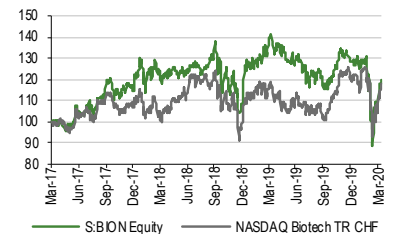
**Price** CHF57.80  
**Market cap** CHF3,202.1m  
**AUM** CHF2,789.4m

NAV\* CHF50.35  
 Premium to NAV 14.8%  
\*Including income. As at 14 April 2020.  
 Yield 5.9%  
 Ordinary shares in issue 55.4m  
 Code BION  
 Primary exchange SIX  
 AIC sector N/A  
 Benchmark Nasdaq Biotechnology index

### Share price/discount performance



### Three-year performance vs index



52-week high/low CHF70.75 CHF45.44  
 NAV\*\* high/low CHF65.50 CHF40.75  
\*\*Including income.

### Gearing

Gross\* 9.1%  
 Net\* 9.1%  
\*At 31 December 2019.

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## Exhibit 1: Company at a glance

### Investment objective and fund background

BB Biotech (BION) is a Switzerland-based 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 those that already have products on the market or have promising drug candidates in advanced stages of development. BION is benchmarked against the Nasdaq Biotechnology index (in Swiss francs) but is managed on a bottom-up basis, with a concentrated c 20–35 stock portfolio.

### Recent developments

- 19 March 2020: all proposals passed at AGM, including shareholder approval of the CHF3.40 dividend in respect of FY19. Two new directors were elected – Professor Dr. Mads Krosggaard Thomsen and, with effect from 1 October 2020, Dr Susan Galbraith. Professor Dr Klaus Strein retired from the board.
- 21 February 2020: results for the year ended 31 December 2019. NAV increased by 23.4% in CHF, 28.1% in EUR and 25.1% in USD. Share price total return of 18.5% in CHF and 23.0% in EUR. The Nasdaq Biotechnology index total return was 25.0% in USD.

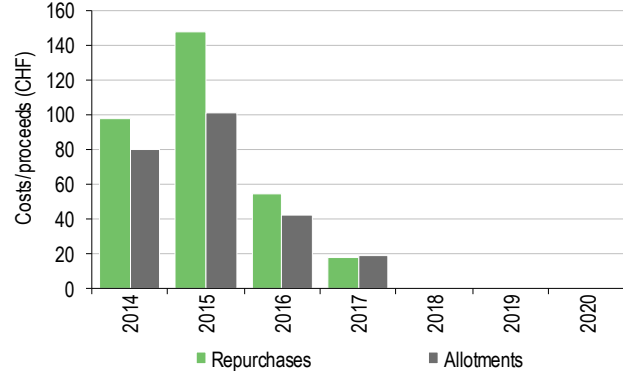
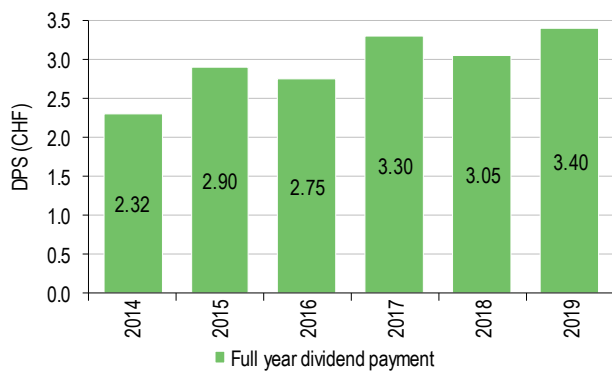
Forthcoming		Capital structure		Fund details	
AGM	March 2021	Total expense ratio	1.26% (31 December)	Group	Bellevue Asset Management
Quarterly results	24 April 2020	Net gearing	9.1% (31 December)	Manager	Team led by Daniel Koller
Year end	31 December	Annual mgmt fee	1.1% of market cap	Address	Schwertstrasse 6, 8200 Schaffhausen, Switzerland
Dividend paid	March (out of capital)	Performance fee	None	Phone	+41 44 267 67 00
Launch date	November 1993	Company life	Indefinite	Website	<a href="http://www.bbbiotech.com">www.bbbiotech.com</a>
Continuation vote	None	Loan facilities	Bank loan (CHF150m drawn)		

### Dividend policy and history (financial years)

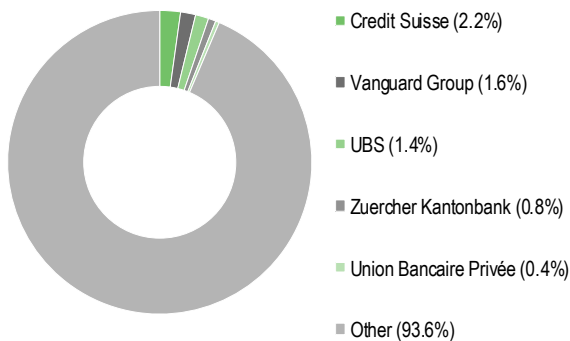
Under a policy in place from 2012, BION makes an annual cash distribution equivalent to c 5% of the volume-weighted average December share price. Dividends restated to take account of five-for-one stock split in March 2016.

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

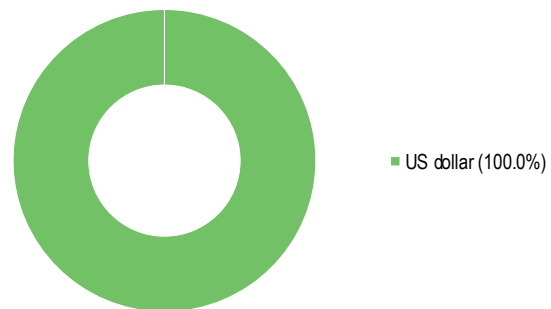
BION has the authority, renewed every three years, to repurchase up to 10% of its issued share capital over a three-year period. As part of the distribution policy announced in 2012, it may return up to 5% of its share price through buybacks throughout the year.



### Shareholder base (as at 4 March 2020)



### Portfolio exposure by currency (as at 31 December 2019)



### Top 10 holdings (at 31 December 2019)

Company	Country	Main clinical focus	Portfolio weight %	
			31 December 2019	31 December 2018*
Ionis Pharmaceuticals	US	Genetic diseases	13.3	15.1
Neurocrine Biosciences	US	Neurological diseases/women's health	9.5	7.6
Incyte	US	Oncology	8.2	7.8
Vertex Pharmaceuticals	US	Orphan diseases	7.5	7.3
Esperion Therapeutics	US	Cardiovascular diseases	6.1	5.0
Agios Pharmaceuticals	US	Oncology	5.1	4.3
Alnylam Pharmaceuticals	US	Genetic diseases	5.1	N/A
Argenx (ADR)	Netherlands	Orphan diseases	4.2	N/A
Alexion Pharmaceuticals	US	Orphan diseases	3.9	4.1
Halozyme Therapeutics	US	Oncology	3.9	3.9
<b>Top 10 (% of portfolio)</b>			<b>66.8</b>	<b>64.0</b>

Source: BB Biotech, Edison Investment Research, Bloomberg, Morningstar. Note: \*N/A where not in end-December 2018 top 10.

## The fund manager: Bellevue Asset Management

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### The manager's view: COVID-19 and the BION portfolio

Lead manager Daniel Koller points out that 2020 started calmly despite the onset of COVID-19 in China, with Western markets largely ignoring it until February, when the spread started in Europe, Italy went into lockdown, and the World Health Organization (WHO) declared a pandemic. Late February and March brought financial market turmoil, with equity market volatility reaching extreme levels, reflecting escalating market fear, and an oil price war causing further asset price corrections. 'In the next couple of weeks, the number of cases in many European countries may peak, and societies and governments will have to reflect on how to continue', he adds.

With c 1.8m cases worldwide and at least 117,000 deaths (at 14 April), Koller says COVID-19 is clearly much more severe than seasonal flu, particularly as the global population has no historical immunity and there is no prophylactic vaccine available. So what can be done? While hospital doctors and nurses are fighting the infection on the front line, Koller explains the healthcare sector can assist in diagnosis and better understanding of the disease transmission then find and test drugs that work at different levels, including direct antiviral medicines for those with moderate to severe symptoms and active infections, as well as prophylactic vaccines.

Looking at the development of specific treatments for COVID-19, Koller says that existing antimalarial drugs chloroquine and hydroxychloroquine have had mixed results so far. He adds there are also marketed products from companies such as Roche and Regeneron that are being used off-label to tackle inflammation of the lungs and tune down the immune response to the virus.

However, the most important weapon in the fight against COVID-19 will be a prophylactic vaccine, 'the virus is likely to resurface, so we need a vaccine for future waves', the manager says. BION portfolio company Moderna (see below) is leading the development of a messenger-RNA (mRNA)-based vaccine, says Koller, ahead of BioNTech, CureVac and Translate Bio. Meanwhile, many firms are working on recombinant sub-unit vaccines, from smaller biotech companies to the major pharmaceutical names including Johnson & Johnson, Sanofi, GlaxoSmithKline and Pfizer.

'The drug industry has a unique chance to influence and win the fight against COVID-19', says the manager. 'It could lead to a substantial improvement of public opinion towards the sector'. However, with companies' focus on developing and offering a medical solution rather than on profitability, he says 'the economic meaning may be rather limited'. Koller argues that as investors, he and his team must resist chasing momentum and look beyond the market noise, because for many drug candidates, he says the picture 'is not clear in terms of clinical success nor how they can generate returns'.

Moderna is one of a number of companies (which collectively make up c 25% of BION's portfolio) using RNA-based technology to develop medicines for a variety of indications. It has been in the portfolio since Q118. Koller explains the company is pioneering mRNA-based medicines, which transport information into the cytoplasm of cells where it will be translated into proteins, driving function on a cellular level. 'Moderna already has solid proof-of-concept in other virus vaccine trials such as cytomegalovirus, Zika and respiratory syncytial virus,' says the manager. 'It has been the fastest company developing a potential prophylactic vaccine candidate for the novel coronavirus SARS-CoV-2 on the basis of its technology – it had its first clinical candidate within 42 days of selecting the amino acid sequence and trials began in mid-March'. He adds that if the FDA allows for an 'at risk' launch, most possibly restricted for at-risk [high-risk?] populations, it could ramp up to producing millions of doses by Q420, which could help up to 50 million people in the next few quarters.

Moderna's share price rose by c 90% between 21 February and 14 April 2020. However, it has been volatile even on the way up, and it is important to stress that with trials still at an early stage, it is by no means clear whether its coronavirus vaccine candidate will prove a success.

Koller says the team has reviewed the portfolio in light of COVID-19 and has maintained its revenue and profit outlook for the time being. 'We have looked at industry-wide implications for ongoing and future clinical trials; some early-stage trials have been put on hold but maintaining trial quality and standards is more important than speed and enrolments', he adds.

## The portfolio

At 31 December 2019 (end-FY19) there were 35 holdings in BION's portfolio, the same number as a year earlier. The fund has a concentrated approach, with the top 10 holdings making up around two-thirds of the portfolio. New positions come in at 0.5–2.0% and grow through market performance as they achieve clinical success. The top holding, genetic diseases specialist Ionis Pharmaceuticals, was a 13.3% position at end-December 2019.

The portfolio is built from an investment universe of c 1,000 listed and late-stage private equity companies, selected by a six-strong team of investment professionals based in New York and Zurich, with a variety of scientific and medical specialisms. Currently the main clinical focuses of the portfolio are on oncology, orphan diseases, central nervous system disorders and cardiovascular or metabolic syndromes (Exhibit 2). There is also diversification by treatment type – from daily, weekly or monthly, to annual or once-only treatments (such as gene editing).

<b>Exhibit 2: Portfolio distribution by clinical focus (% unless stated)</b>			
	Portfolio end-December 2019	Portfolio end-December 2018	Change (pp)
Orphan diseases	39.0	37.2	1.8
Oncology	25.2	25.6	(0.4)
Neurological diseases	15.8	16.4	(0.6)
Cardiovascular diseases	8.7	6.4	2.3
Metabolic diseases	8.3	7.3	1.0
Infectious diseases	0.2	3.3	(3.1)
Other	2.8	3.8	(1.0)
	<b>100.0</b>	<b>100.0</b>	

Source: BB Biotech, Edison Investment Research

A strategic portfolio realignment initiated in the summer of 2018 was largely completed by the end of 2019. Positions in eight mostly large-cap companies were exited and another six positions were closed as a result of M&A activity. Meanwhile, 14 new positions were opened in what the managers see as promising small and mid-sized companies, including CRISPR Therapeutics (gene editing), Homology Medicines (gene therapy), Molecular Templates (targeted toxin delivery) and Arvinas (small molecules). Koller says BB Biotech's current portfolio is 'superbly positioned' to capture major innovation and growth opportunities within the biotech industry and to sustain its target return of 15% pa over the medium to long term.

<b>Exhibit 3: Portfolio distribution by market capitalisation (% unless stated)</b>			
	Portfolio end-December 2019	Portfolio end-December 2018	Change (pp)
>\$30bn	8.9	15.5	(6.6)
\$5–30bn	48.1	45.8	2.3
\$1–5bn	32.1	28.0	4.1
\$500m–1bn	9.0	9.0	0.0
<\$500m	1.9	1.7	0.2
	<b>100.0</b>	<b>100.0</b>	

Source: BB Biotech, Edison Investment Research

This positioning is evident in the breakdown of the portfolio by market capitalisation (Exhibit 3). Koller says there is an increase in the number of mid-caps turning sustainably profitable, moving up what the BION team describes as an S-curve (with early-stage companies growing relatively slowly, then enjoying a period of rapid growth as they achieve clinical success and build scale, before

flattening out again once they reach the more mature stage). ‘How we invest is by targeting small and mid-cap companies with the best potential’, he says. ‘You need to take a long-term view to allow them to evolve over the S-curve and become large caps; then we take profits and reinvest into the next generation of growth companies.’

## Performance: Longer-term returns validate strategy

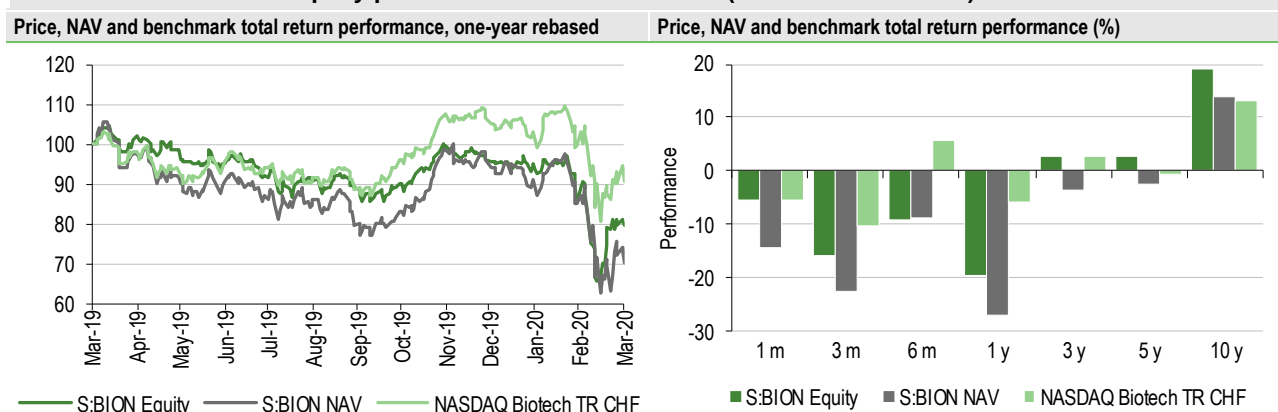
**Exhibit 4: Five-year discrete performance data**

12 months ending	Share price (%)	NAV (%)	NASDAQ Biotech CHF (%)	MSCI World Health Care CHF (%)	CBOE UK All Cos CHF (%)
31/03/16	(18.5)	(24.9)	(25.0)	(9.1)	(8.5)
31/03/17	29.2	30.0	18.2	13.9	11.5
31/03/18	24.3	10.3	5.1	4.9	8.7
31/03/19	8.3	11.7	9.4	17.3	2.6
31/03/20	(19.5)	(27.0)	(5.6)	(1.5)	(25.2)

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

In the short term, BION's focus further down the market capitalisation spectrum has proved a headwind, as investors perceive larger companies to be ‘safer’ during a market sell-off such as that experienced in March and April 2020 as a result of the COVID-19 pandemic. ‘Our small and mid-cap exposure has made the last few weeks tougher, particularly on a relative basis as large caps were also the first beneficiaries of the market rebound, but it is fundamental to our approach of investing in innovation’, says Koller. As shown in Exhibit 4, although BION's share price and NAV total returns trailed the benchmark Nasdaq Biotech index (in Swiss francs) over the 12 months to 31 March 2020, it outperformed on an NAV basis in each of the four previous discrete 12-month periods and in share price terms over all but one.

**Exhibit 5: Investment company performance to 31 March 2020 (in Swiss franc terms)**



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

**Exhibit 6: Share price and NAV total return performance, relative to indices (% in Swiss franc terms)**

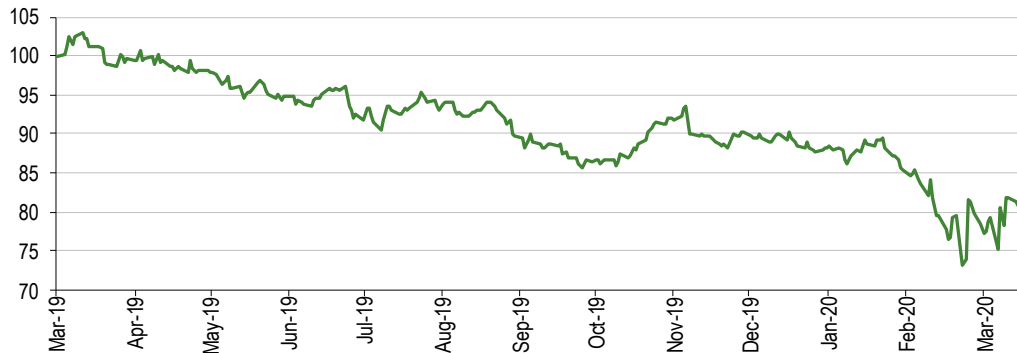
	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to NASDAQ Biotech	0.0	(5.3)	(14.7)	(13.9)	(0.2)	17.9	235.2
NAV relative to NASDAQ Biotech	(9.0)	(12.0)	(14.4)	(21.4)	(18.6)	(8.4)	22.4
Price relative to MSCI World Health Care	(1.9)	(4.3)	(7.1)	(18.0)	(12.9)	(11.5)	309.4
NAV relative to MSCI World Health Care	(10.8)	(11.0)	(6.8)	(25.5)	(31.4)	(37.8)	96.5
Price relative to CBOE UK All Cos	12.3	14.8	15.4	5.7	25.0	29.1	463.9
NAV relative to CBOE UK All Cos	3.3	8.1	15.7	(1.8)	6.6	2.7	251.0

Source: Refinitiv, Edison Investment Research. Note: Data to end-March 2020. Arithmetic calculation.

Although the magnitude of the drawdown in the past 12 months has also dented longer-term returns on both an absolute and a relative basis (Exhibit 5, right-hand chart), over 10 years BION has produced annualised share price and NAV total returns of c 19% and c 14% respectively, compared with c 13% for the benchmark. This is largely in line with or ahead of BION's target of

c 15% per year compound returns over the long term. It is also important to note that sentiment towards biotech stocks (particularly among generalist investors) can be volatile and that historically the rebounds have been just as pronounced as the setbacks.

**Exhibit 7: NAV total return performance relative to Nasdaq Biotech index over one year**



Source: Refinitiv, Edison Investment Research

## Valuation: At a premium and committed to 5% dividend

**Exhibit 8: Share price premium/discount to NAV (including income) over three years (%)**



Source: Refinitiv, Edison Investment Research

BION's shares enjoyed a substantial re-rating from 2016 onwards, moving from a persistent double-digit discount to a double-digit premium to NAV. After a very strong Q319, sentiment towards the healthcare sector began to cool in the fourth quarter and BION's premium followed suit, declining from c 20% to c 5% by the year end. As the market sell-off took hold in late February and into March 2020, the rating became more volatile, with the shares falling to a discount of 2.4% on 13 March (the widest point since late 2017), before rebounding to a 10-year high premium of 24.5% on 23 March, suggesting the presence of bargain-hunting buyers in the market despite recent NAV weakness. At 14 April 2020, BION's shares traded at a 14.8% premium to NAV.

Biotechnology is not generally a high-yielding area of the stock market, as many companies are at a relatively early stage of development and even those with products on the market may be more focused on reinvesting their profits for future growth. However, in recognition of investors' appetite for income in an environment where yields on other assets are low, BION has a policy of paying out some of its capital profits as an annual distribution to shareholders. The rate of the distribution is set at 5.0% of BION's market capitalisation, based on the volume-weighted average share price in December each year. For FY19, this translates to a distribution of CHF3.40, which was paid to investors on 25 March 2020. At the current share price this represents a dividend yield of 5.9%. In an environment of widespread dividend cuts as companies seek to conserve cash amid the COVID-

19 pandemic, Koller says: 'We are committed to our dividend and the board has reaffirmed that the policy will continue for the coming year'. Investors should note that as the distribution is a set percentage of the share price, it may fall or rise in absolute terms from one year to the next.

## Peer group comparison

In Exhibit 9 we show BION and its Switzerland-listed peer HBM Healthcare Investments alongside the constituents of the Association of Investment Companies' Biotechnology & Healthcare sector. All figures are in Swiss franc terms. BION is the largest fund in the group by some margin. It ranks comfortably first in the peer group for NAV total return performance over 10 years; however, it has suffered in the recent sell-off as a result of its small and mid-cap focus and concentrated portfolio, which has affected its ranking over shorter periods. Ongoing charges are broadly average and there is no performance fee. BION is one of three funds in the group currently trading at a premium to NAV; only Syncona's premium is higher. Gearing is slightly above average and BION's c 6% yield is by far the highest in the group, 3.6pp above average and 2.3pp higher than its closest peer.

**Exhibit 9: Selected peer group as at 13 April 2020 (in CHF terms)\***

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Ongoing charge	Perf. fee	Premium/ (discount)	Net gearing	Dividend yield
<b>BB Biotech</b>	<b>2,936.2</b>	<b>(21.4)</b>	<b>0.3</b>	<b>(2.0)</b>	<b>328.7</b>	<b>1.26</b>	<b>No</b>	<b>15.0</b>	<b>109</b>	<b>6.2</b>
BB Healthcare	680.9	(10.8)	22.6	--	--	1.16	No	(1.4)	107	3.8
Biotech Growth Trust	417.7	12.2	19.1	(5.4)	292.5	1.05	Yes	(10.9)	109	0.0
HBM Healthcare Investments	1,189.6	16.6	50.8	80.6	303.8	1.41	No	(18.0)	100	3.8
International Biotechnology Trust	291.6	(4.8)	10.4	(1.7)	211.3	1.27	Yes	(1.5)	100	3.9
Polar Capital Global Healthcare	321.5	(2.7)	12.7	7.8	--	1.13	Yes	(7.9)	110	0.9
Syncona	1,857.4	(14.9)	49.0	44.1	--	1.83	No	16.3	100	1.2
Worldwide Healthcare Trust	2,052.2	3.5	27.9	25.0	240.0	0.90	Yes	3.2	109	0.9
<b>Peer group average (8 funds)</b>	<b>1,218.4</b>	<b>(2.8)</b>	<b>24.1</b>	<b>21.2</b>	<b>275.3</b>	<b>1.25</b>		<b>(0.6)</b>	<b>106</b>	<b>2.6</b>
<b>BION rank in peer group</b>	<b>1</b>	<b>8</b>	<b>8</b>	<b>6</b>	<b>1</b>	<b>4</b>		<b>2</b>	<b>2</b>	<b>1</b>

Source: Morningstar, Edison Investment Research. Note: \*Performance to 10 April 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

BION has recently elected two new directors to its board, bringing the number of independent directors to five. Professor Dr Mads Krogsgaard Thomsen is chief science officer of Novo Nordisk and has joined the board with effect from the March 2020 AGM. Dr Susan Galbraith is head of oncology research and early development at AstraZeneca and will take up her position on BION's board on 1 October 2020. The chairman (since 2013) is Dr Erich Hunziker, who has served on the board since 2011 and is a former CEO of Swiss pharmaceutical giant Roche. Dr Clive Meanwell was CIO of the Medicines Company, which he founded, and is BION's longest-serving director having been appointed in 2003. Dr Thomas von Planta was appointed in March 2019. His background is in investment banking and until 2018 he was chairman of the board of BION's portfolio manager, Bellevue Asset Management. Professor Dr Klaus Strein retired from the BION board at the 2020 AGM, having served as a director since 2013.

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