BB Healthcare Trust

Monthly News
September 2017

As at 09/30/2017	Value	1 Month (September)	YTD	Since Launch (ITD)
Share	115.00	-1.71%	12.40%	16.76%
NAV	112.74	-2.73%	13.22%	14.54%

Welcome to our September update. It was a busy summer for us out on the road. The Republicans, too, kept themselves busy - albeit to no obvious end. One could be forgiven for thinking it has been a quiet summer, though: the GBP MSCI World Healthcare Index currently stands at 169, almost exactly where it was back in early June (and at the end of February too).

Still waters run deep

The Trust's net asset value (NAV) decreased 2.7% over the month to 112.74p. Although disappointing, the Trust performed broadly in line with the MSCI Healthcare benchmark, which declined 2.6% over the month. The impact of foreign exchange was very material: the Benchmark increased 1.2% in US dollar terms (i.e. a -3.8% FX impact) and we estimate that the impact of FX on our portfolio was c3.0% for the month.

Although we do not pretend to be currency analysts, the extent of the pound's rally has surprised us. To us, it feels like the market has priced in the potential downsides around Brexit and is now factoring in a more Hawkish shorter-term outlook from the BoE. With so much uncertainty around the UK economic outlook, our own view is that any short-term upward move in interest rates is likely to be limited in scope and does not necessarily indicate the beginning of a sustained tightening trend. As we noted last month, markets are not obviously rational in the short-term and the Pound has already declined >2% from its mid-September high. None of this changes our longer-term investment strategy – we continue to see much more compelling opportunities in the US healthcare space and will likely remain focused there in terms of capital deployment.

Every sub-sector of healthcare declined in September, although again there was a significant divergence across the categories, with many sectors seeing one or two companies suffer major setbacks, which rather distorted the picture in what is normally a quiet month newsflow-wise.

CHART SUB-SECTOR / CONTRIBUTION

Sub-Sector	Weighting	Performance
Biotech	12.8%	-4.2%
Conglomerate	13.3%	-3.1%
Diagnostics	2.0%	-7.4%
Distributors	2.0%	-3.5%
Facilities	1.1%	-5.1%
Healthcare IT	1.1%	-1.8%
Managed Care	8.6%	-4.6%
Med-Tech	12.8%	-4.3%
Other HC	0.7%	-2.1%
Pharma	35.6%	-0.1%
Services	1.7%	-4.4%
Specialty Pharma	4.6%	-5.6%
Tools	3.7%	-1.8%

Quelle: Bellevue Asset Management, 30.09.2017

Summary

BB Healthcare Trust is a high conviction, unconstrained, long-only vehicle invested in global healthcare equities with a max of 35 stocks. The target annual dividend is 3.5% of NAV and the fund offers an annual redemption option. BB Healthcare is managed by the healthcare investment trust team at Bellevue Asset Management, which also manages BB Biotech.

Once again, intra-sector volatility has been notable and the environment remains febrile, with what feels like a "trade first, analyse later" mind-set. On the plus side, this is opening up a number of potential good entry points into quality long-term stories and we may well increase the number of holdings in the coming weeks.

In terms of the NAV evolution, the three most significant positive contributors this month (and their local currency performance) were Alnylam (Biotech +37%), Align (Med-Tech +5%) and Abbvie (Biotech +18%). This month's largest negative contributors were Wright Medical (Med Tech, –13%), Anthem (Managed Care –3%) and Tenet Healthcare (Facilities, -4%).

Developments within the Trust

As noted previously, we have been on the road, seeing shareholders and prospective investors. There were a few recurring themes from these meetings and we will expand on some of these below. Following the roadshow, we concluded a secondary offering that raised £64 million, resulting in the issuance of 57.2m new shares. Our market capitalisation is approaching £300m and we are on track to double the size of the Trust within its first year. We thank you all for your continued support and welcome our new investors.

The additional capital was deployed within a few trading days. However, we have yet to draw down any additional monies from our lending facility as we evaluate options for new holdings. Therefore, our leverage ratio has declined from 5.5% at the end of last month to 4.0% at the end of September. We continue to expect the leverage ratio to increase as we move toward the end of the year.

Following the capital deployment, we have broadly maintained overall weightings in the portfolio at similar levels to last month, although we took some profits in both Alnylam and Abbvie as they are approaching our fair values following the strong performance highlighted above.

Investor themes

One recurring question was how true to our low turnover philosophy, we have managed to be thus far. During the IPO process, we estimated that annual turnover would be around 25%; this was based on the historical turnover of BB Biotech, with which we share a similar philosophy as well as a management team. If we exclude the trading impact of new capital going into the book from equity issuance and drawing down of the loan facility, we have traded a value equivalent to 27% of gross assets since inception to end August, averaging 3.0% per month. Within this, ~8% can be attributed to M&A activity (i.e. forced selling of acquired companies). If we annualise these figures, it suggests the ex-M&A turnover ratio will indeed be in the low 20s.

The potential impact of Amazon on the pharmacy market was another recurring discussion point, especially given our exposure to drug retail and wholesale (through positions in Walgreens Boots and AmerisourceBergen). This has become a major topic, with three sell-side conference calls on the topic last week. Indeed, UBS informed us that their call garnered around 5x the normal level of interest for such events.

We are sceptical that US prescription pharmacy is a major focus for Amazon at the present time. They have limited cash on hand after the Whole Foods purchase and we wonder if this is the best use of debt capacity for them. Amazon is a growth company and Pharmacy is a huge market with low margins and slow growth. Because of this, scale is important and acquiring a large PBM would distort their comps quite a lot. Mail order pharmacy is actually a stagnant market, in part because consumers like to go to the pharmacy and in part because insurers are no longer driving mail as a way to save money, rightly recognising that the most important thing is making sure patients actually take their medicines (and this is an area where the two major national pharmacy chains are uniquely positioned to take a more active role). We are exposed to the potential upside on the OTC channel side from Amazon via Perrigo, their partner on a range of OTC products.

Inevitably, the US political situation dominated discussions, with the three main threads being the prospective impact of tax reform were it to take place, the potential for further healthcare reform efforts and the bogeyman of drug pricing reform. On the reform topic, we could not have imagined that the Republicans would have another go at repealing Obamacare so soon (although the eventual outcome of another failure was arguably much easier to foresee).

We have pretty much exhausted our list of humorous metaphors for this situation and it is worrying times indeed when the politicians' propensity to mess up exceeds society's capacity to satirise them. The pattern was as before: they crash the bus; they get the bus back out the garage and crash it again. Amazingly, the learning from the failure of the Graham-Cassidy plan appears to be: have another go once tax reform is done. We see no different outcome – two Republican Senators seem opposed to anything beyond total repeal on ideological grounds (Cruz, Paul) and two more seem opposed to anything that is not debated and bipartisan (McCain and Collins).

All the while, this goes on, creating a level of uncertainty around the wider sector that is undoubtedly negatively impacting sentiment. At some stage,

TOP 10 HOLIDINGS

Align Technology	8.4%
Anthem	6.2%
Celgene	6.1%
Illumina	5.9%
Intuitive Surgical	5.0%
Amgen	5.0%
Walgreens Boots Alliance	4.9%
Eli Lilly	4.9%
Gilead Sciences	4.1%
Amerisourcebergen	4.1%

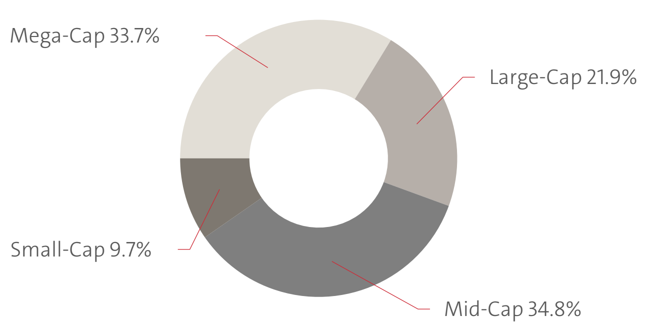
Source: Bellevue Asset Management, 30.09.2017

SUB SECTOR BREAKDOWN

Biotech	25.7%
Medtech	28.3%
Specialty Pharma	11.0%
Pharma	10.1%
Diagnostics	7.2%
Managed Care	6.2%
Other Healthcare	4.9%
Distributors	4.1%
Facilities	2.5%

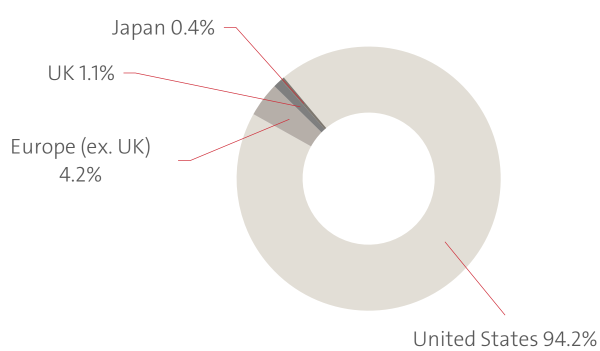
Source: Bellevue Asset Management, 30.09.2017

MARKET CAP BREAKDOWN



Source: Bellevue Asset Management, 30.09.2017

GEOGRAPHICAL BREAKDOWN (OPERATIONAL HQ)



Source: Bellevue Asset Management, 30.09.2017

"five companies representing ~14% of the portfolio have a non-US legal domicile (primarily for tax reasons) but operate out of the United States and their primary stock market listing (in terms of volume traded) is in the United States".

we will move beyond this topic (surely even the most blowhard Republicans have a pain threshold?) and see a positive improvement toward healthcare sentiment in the medium-term. We remain convinced that this period of uncertainty is a good entry point into visible structural long-term growth at attractive valuations, which is in part why we undertook the secondary offering at this point.

Our views on tax reform are unchanged; we remain hopeful of a broad cut to the Federal tax rate and some sort of repatriation window that would enable companies to bring offshore monies back into the US on terms that This may well trigger a wave of M&A and accelerated share buybacks. As we have noted before, the main beneficiaries of a rate cut are those companies least able to mitigate their Federal liabilities by taking advantage of tax credits, namely onshore companies with predominantly domestic operations that do not undertake R&D (insurers, retailers, services etc.). Relative to the benchmark, we are more exposed to such companies and continue to see this opportunity as a broad positive for our portfolio.

Drug pricing is the bogeyman that will not die. The concern around this topic amongst generalist investors is palpable and the industry continues to do itself no favours on the PR front. The latest own goal being Allergan's transfer of patent rights to a Native American tribe (effectively a sovereign nation) to curtail potential routes for litigation. Clever as this may be (and probably successful too), it is precisely the sort of innovation that politicians love to hate and it is unsurprising that some Senators are calling for a Congressional investigation. Whilst no laws have been broken, the risk perception for an investor cannot be viewed in a positive light.

This having been said, we must focus on realpolitik. Inveigh as it might, the legal basis for Congress or the US government to ingratiate itself into the regulation of drug prices is essentially non-existent. Moreover, there is scant evidence of any will on the Republican side to get involved in drafting legislation in this area. Whilst the Republicans cannot seem to pass anything, their ability to block democrats remains as long as they have the White House. Nothing can become law unless the President signs it.

On a practical level, consumer (i.e. voter) interest in the topic will arguably wane if drug price inflation reverses and monthly premiums for Medicare Part D (prescription drugs for the elderly) are expected to be around 3% lower in 2018 vs 2017. Real-time rebate algorithms may soon enable consumers to see the net rather than the gross price of the drugs they consume (and their employer pays for), which might help with the perception issues around drugs being viewed as cheaper in say Canada. Again, we see no clear-cut ending to the debate, but rather a gradual fade from consciousness. It is as the chieftain in Asterix wryly observed "The sky may fall on your head tomorrow... but tomorrow never comes".

Finally, on a related note, the topic of why we are so cautious on mega-cap pharma (<9% of our portfolio vs. c37% of the benchmark if we include companies like J&J). Drug pricing is not a factor; it is rather the low growth and serially low R&D productivity of this group that bothers us. We simply do not see the potential for compelling probability-adjusted returns, save for a few exceptions (Shire, Lilly). There is also the issue of risk, where the reality of diversification in such companies can be illusory (cf. Astra's 15% fall on a single trial read-out a few months back). For that sort of risk, you should be expecting a much better level of return potential. If you want diversified healthcare exposure with income and the potential for decent capital appreciation, then we suggest you look at... BB Healthcare Trust Plc!

Paul Major, Daniel Koller and Brett Darke

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INVESTMENT FOCUS

- The BB Healthcare Trust invests in a concentrated portfolio of listed equities in the global healthcare industry (maximum of 35 holdings)
- Managed by Bellevue Asset Management AG ("Bellevue"), who manage BB Biotech AG (ticker: BION SW), Europe's leading biotech investment trust
- The overall objective for the BB Healthcare Trust is to provide shareholders with capital growth and income over the long term
- The investable universe for BB Healthcare is the global healthcare industry including companies within industries such as pharmaceuticals, biotechnology, medical devices and equipment, healthcare insurers and facility operators, information technology (where the product or service supports, supplies or services the delivery of healthcare), drug retail, consumer healthcare and distribution
- There will be no restrictions on the constituents of BB Healthcare's portfolio by index benchmark, geography, market capitalisation or healthcare industry sub-sector. BB Healthcare will not seek to replicate the benchmark index in constructing its portfolio

FIVE GOOD REASONS

- Healthcare has a strong, fundamental demographic-driven growth outlook
- The Fund has a global and unconstrained investment remit
- It is a concentrated high conviction portfolio
- The Trust offers a combination of high quality healthcare exposure and a 3.5% dividend yield
- BB Healthcare has an experienced management team and strong board of directors

MANAGEMENT TEAM

Paul Major

Daniel Koller

Brett Darke

GENERAL INFORMATION

Issuer	BB Healthcare Trust (LSE main Market (Premium Segment, Offical List) UK Incorporated Investement Trust
Launch	December 2, 2016
Market capitalization	GBP 292 million
ISIN	GB00BZCNLL95
Investment Manager	Bellevue Asset Management AG; external AIFM
Investment objective	Generate both capital growth and income by investing in a portfolio of global healthcare stocks
Benchmark	MSCI World Healthcare Index (in GBP) - BB Healthcare Trust will not follow any benchmark
Investment policy	Bottom up, multi-cap, best ideas approach (unconstrained w.r.t benchmark)
Number of ordinary shares	193 237 221
Number of holdings	Max. 35 ideas
Gearing policy	Max. 20% of NAV
Dividend policy	Target annual dividend set at 3.5% of preceding year end NAV, to be paid in tow equal instalments
Fee structure	0.95% flat fee on market cap (no performance fee)
Discount management	Annual redemption option at/close to NAV

DISCLAIMER

CONTACT

Bellevue Advisors Limited
Claude Mikkelsen, Director of Investor Relations
Phone: +44 (0) 203 326 29 83
Moblie Phone: +44 (0) 755 704 85 77
E-Mail: cmi@bellevue.ch
32 London Bridge Street
24th Floor
GB-SE1 9SG London
www.bbhealthcaretrust.com