BB Healthcare Trust

Monthly News
November 2017

As at 11/30/2017	Value	1 Month (November)	YTD	Since Launch (ITD)
Share	118.75	3.26%	16.07%	20.57%
NAV	115.39	2.31%	15.89%	17.23%

Welcome to our November update. The holiday season is upon us and, frankly, we could all do with a rest. Indeed, we erred with respect to putting pen to paper, for the siren song of the sell-side led us to wonder briefly if Amazon's seemingly relentless bid for global healthcare dominance would include disrupting the investor factsheet industry. Alas, our Prime membership does not seem to include this service yet and you are stuck with our authorship once more...

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.

Happy Birthday!

As the first snow flurry of winter descended on London, 'tis truly the season to be jolly. For not only, does the mince pie maelstrom loom (here at Bellevue Towers, we are rather partial to the offering from Konditor and Cook in Borough Market), but it is also the anniversary of the Trust's inception on 2 December 2016. We shall include some annualised performance commentary to our November year-end below.

During November, the Trust's ex-income net asset value (NAV) rose 2.3% to 115.39p. In sterling terms, the MSCI Healthcare benchmark rose only 0.3%. Once again, FX played a dominant role in the overall monthly return, given all of the back and forward around Brexit. When measured in dollars, the benchmark rose 2.1%, as some sectors staged a recovery from the mixed reporting season and excitement over the potential impact of tax reform helped healthcare sentiment.

We have included a summary of the Benchmark's sub-sector performance on a monthly and annual basis in Figure 1 below (note – we have slightly revised our sub-sector classification system to better reflect differing payor dynamics within some segments).

In the year since inception, the Trust has delivered a total return (including the 1.75p dividend) of 20.5%, versus a comparable sterling total return of 14.5% for the benchmark index, an outperformance of 608 basis points (bp). Although the share's premium to NAV contributes 295 bp to this, one should also take into account that the inception price of 100p included investable assets of only 98.2p after setup fees and thus the annual return calculation includes a 177bp headwind. The 'clean' NAV return (i.e. that which can be attributed to the investment managers) was 19.3% over the period.

BENCHMARK SUB-SECTOR PERFORMANCE AND WEIGHTINGS

	November (month)		Year since inception	
Sub-Sector	Weighting	Performance	Weighting	Performance
Biotech	11.2%	-3.1%	11.8%	-0.5%
Conglomerate	13.4%	-2.4%	12.3%	11.2%
Dental	0.5%	6.5%	0.7%	91.2%
Diagnostics	1.6%	5.2%	1.5%	25.2%
Distributors	1.8%	0.8%	2.3%	-8.8%
Facilities	1.0%	6.2%	1.2%	-1.6%
Health Tech	0.1%	27.7%	0.1%	-10.6%
Healthcare IT	1.2%	1.7%	1.0%	35.0%
Managed Care	9.0%	6.1%	7.5%	34.4%
Med-Tech	13.4%	0.0%	12.5%	16.9%
Other HC	0.7%	11.3%	0.6%	23.4%
Pharma	35.3%	0.5%	36.9%	3.2%
Services	2.3%	-0.9%	2.7%	-7.6%
Specialty Pharma	4.2%	-0.5%	5.5%	-15.6%
Tools	4.3%	-2.5%	3.5%	23.1%

Source: Bloomberg/MSCI. YTD performance is from 1-1-16 to 30-11-17. Weightings for YTD are from 30-11-16

Looking at the sub-sectors, November was a challenging month for the Therapeutics categories, especially Biotech. Our holdings in Diagnostics, Managed Care, Dental and Health-Tech helped us to outperform during the month. Looking at the year since inception, our strategy precludes holding conglomerate companies and these have performed well. We also chose to eschew the Tools and Healthcare IT sub-sectors and these have outperformed.

Valuations in the Tools segment remain at all-time highs and these in turn are predicated on the longer-term sustainability of the very favourable market conditions enjoyed in recent years. We remain unconvinced that such optimism is justified. In Healthcare IT, we continue to bump up against issues around competitive dynamics and longer-term growth. Many of these companies operate in contract-driven markets and getting comfortable over the retention of market share and payment rates for future services can be very challenging. That said, some niche areas of IT services have robust demographic drivers and, for now at least, potential competitive barriers and we are evaluating select opportunities in such companies.

In terms of the NAV evolution, the three most significant positive contributors this month (and their local currency performance) were Align (Dental, +9%), Anthem (Managed Care, +12%) and Illumina (Diagnostics, +12%). This month's largest negative contributors were Incyte (Biotech, -13%), Philips (Med-Tech, -5%) and Wright Medical (Med-Tech, -7%).

Developments within the Trust

We have issued a further 2.75m shares during November and have completed our review of the portfolio that we began in September. This process has resulted in five additional position closures (Amgen, Lundbeck, Mallinckrodt, Perrigo and Vectura) to leave us with 27 holdings in the Trust.

- **Amgen** delivered a 21% total return over our holding period. Our thesis was largely predicated on higher out-year earnings forecasts versus the market, but that gap had largely closed over the year and so we did not see a compelling opportunity for similar returns into 2018.

- **Lundbeck** delivered a 44% % total return over our holding period, although we gradually sold out of the position on strength and fared better than this in terms of our own IRR. This was a new product launch and restructuring story that had run its course and we expected the shares to tread water at best though 2018 and so re-deployed the capital. This proved prescient, as the shares have fallen 18% since we sold them.

- **Mallinckrodt** has undoubtedly been a painful and chastening experience. We lost more than 50% of our invested capital on this position, despite our average entry price representing a five-year low in the period up to mid-2017 and the stock trading on P/E ratio of <3x!. The emergence of various uncertainties regarding the payor dynamics for Achtar (38% of revenues), coupled with the uncertainty of being able to exit its scheduled drug generics business for good price when the opioid crisis has been declared a Federal emergency leaves our value based thesis around these assets difficult to quantify.

- **Perrigo** was another benighted 'specialty pharma' story that we felt offered re-rating potential, based on the attractions of its core 'white label' OTC business. However, the OTC segment has proved to be a more challenging one in general for the pharma industry due to changing consumer behaviour and we felt that the likely upside and time to attain that upside were no longer compelling, so we exited the position with a modest positive IRR.

- **Vectura** has been a disappointing investment. Our thesis was predicated on the potential for the US approval of a generic Advair. The stock travelled nicely into the event and, with hindsight, we should have sold out at that point. In the end, the approval was not forthcoming. Following meetings with the management of both Hikma (its commercialisation partner) and Vectura, we were happy to continue to hold the shares pending resubmission. However, it was disclosed in November that the FDA's issues with the submission were potentially more serious than we had assumed, risking a prolonged resolution. We exited the position with a capital loss of 30%, albeit on a small position.

With the exception of Amgen, these were smaller tail positions (each <1.6% of the portfolio) trimmed on an 'opportunity cost of capital basis' – put simply, we felt our marginal dollar would be better used elsewhere in the portfolio from a risk/return basis. In addition to these exits, we have re-weighted a number of positions to even up the book. As a consequence, our average position size has risen from 3.1% to 3.4% of gross assets. We are completing our due diligence on a number of new ideas that could enter the portfolio around the turn of the year.

Some thoughts on innovation

Many of you will be very aware of our less-than-favourable views of large-cap pharma. This is a considered view, borne of the demonstrably low R&D productivity showed by these companies. Most of the interesting new products are in-licensed or acquired and we prefer to own the biotechnology companies such products are typically sourced from.

Although the empirical evidence to support these statements is numerous, none of it gets to the question of why this is the case. After all, these companies are all fishing from the same pools of talented PhD students at elite universities for their future R&D stars and they are all attending the same scientific conferences in terms of knowing what is at the cutting edge of current medical thinking.

Nor can one convincingly argue that there is any experiment out there that 'big pharma' lacks the equipment or personnel to undertake – quite the opposite in fact. Finally, when it comes to making a new molecule or screening a library of putative compounds suitable for a novel target, can one really imagine a 'guerrilla' start-up outgunning the likes of, say, Pfizer?

We were fortunate to spend a couple of days in the US with our BB Biotech colleagues, touring biotechnology companies in the Cambridge area. Many and varied were the technologies and treatments on offer, but equally there was a commonality to the back stories from a number of these companies' founders.

These could be summarised along the lines of "I used to work in big pharma and then I had this idea to look at XYZ but they didn't want to, so I went out on my own". Often these ideas seemed tangential (even heretical) to their employers and yet have since gone on to underpin new treatments, thousands of jobs and substantial amounts of shareholder value. Why does large pharma often not want to sponsor these projects internally? This is, quite literally, a billion dollar question.

Perhaps even more fascinating is when one segues the same discussion into medical devices. For instance, if we look at the orthopaedic segment, the market dynamic in areas like spine and extremities is for large established players to lose share to new entrants who seem to bring new innovations to market more rapidly.

These developments are typically more incremental in nature and can be introduced more quickly than in the world of pharma/biotech. However, they are associated with high capital intensity around instrumentation, so whilst the R&D bar is set lower, the overall bar from an invested capital perspective remains considerable.

Given the intimacy of the relationship between the surgeon and the sales rep in this field, there can be no excuse for the large companies not being on top of what the market wants next and yet they still seem to lose out. If you want a really expensive (but arguably not very useful) innovation like a robot, then the big guys are all over it, but the smaller stuff they can't seem to get right.

This debate around the ability to reproduce and manage innovation has been raging for decades and will likely continue for many years to come. We can offer no compelling insights to help the incumbents but note that an unconstrained mandate like ours that enable us to move away from these so-called 'blue chip' companies and instead own the disruptive innovators seems a very logical approach until there are clearer answer to this most fundamental of questions.

Roll on 2018

We would like to thank you again for your support in making BB Healthcare's market debut a success and wish you all a happy and prosperous end to the year. Finally, for anyone who does over-indulge in those mince pies, you can always "re-discover your beautiful" with SculpSure – and thus avoid the January diet and contribute to our future investment performance!*

Paul Major, Daniel Koller and Brett Darke

**Disclaimer – the investment managers in no way condone vouchers for fat reduction treatment as a good Christmas present idea. Indeed, this seems like a terrible idea.*

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SUB SECTOR BREAKDOWN

Med-Tech (ex. Dental/Health Tech)	24.1%
Biotech	17.3%
Pharma	9.7%
Dental	9.2%
Spec. Pharma	8.0%
Managed Care	7.3%
Diagnostics	7.3%
Health Tech	5.9%
Other Healthcare	5.0%
Distributors	4.2%
Facilities	2.1%

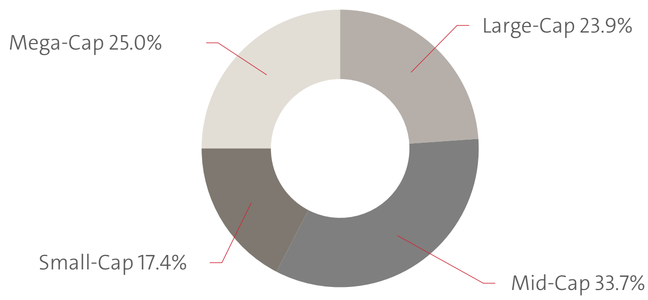
Source: Bellevue Asset Management, 30.11.2017

TOP 10 HOLIDINGS

Align Technology	9.2%
Anthem	7.3%
Illumina	6.5%
Celgene	5.7%
Intuitive Surgical	5.5%
Shire	5.1%
Walgreens Boots	5.0%
Eli Lilly	4.6%
Amerisourcebergen	4.2%
Incyte	3.9%

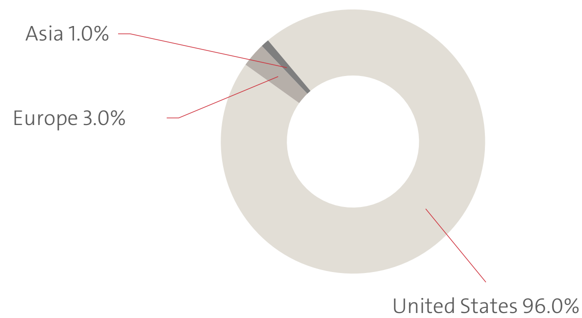
Source: Bellevue Asset Management, 30.11.2017

MARKET CAP BREAKDOWN



Source: Bellevue Asset Management, 30.11.2017

GEOGRAPHICAL BREAKDOWN (OPERATIONAL HQ)



Source: Bellevue Asset Management, 30.11.2017

"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".

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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 308 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

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