

BB Biotech AG

Sector specialist with high distribution policy

BB Biotech (BION) seeks to achieve long-term capital growth by investing in fast-growing biotech companies. A discount management programme adopted in 2012 allows it to return 5% of its value each year as a capital distribution, resulting in an unusually high yield (6.4% at 3 February) for a fund investing in a low-yielding sector. Biotech has performed strongly and BION has beaten the benchmark NASDAQ Biotech index in three of the last five years, although it has underperformed in a sharp sell-off since the start of 2016. The fund invests globally and across the size spectrum, with a concentrated portfolio heavily weighted towards 5-8 core holdings. It is currently focused more on primary care end-markets, where the lower-cost, higher-volume model is less affected by political pressure on pricing.

12 months ending	Total share price return (%)	Total NAV return (%)	NASDAQ Biotech (%)	MSCI World Healthcare (%)	FTSE All-Share (%)
31/01/12	18.8	13.7	21.5	9.6	(3.9)
31/01/13	34.9	38.3	25.1	22.8	15.7
31/01/14	71.5	81.9	68.5	28.0	13.5
31/01/15	71.8	47.0	33.4	22.6	(0.6)
31/01/16	(6.3)	(17.1)	(7.2)	7.4	0.3

Note: Twelve-month rolling discrete CHF-adjusted total return performance.

Investment strategy: Clinical focus is key

BION is managed by the specialist healthcare investor Bellevue Asset Management. The management team includes qualified medical doctors, bioscientists and economists. A four-stage investment process sees a universe of c 800 companies distilled to a portfolio of 20-35 stocks by focusing on the clinical landscape, pipeline developments, management and financial strength. BION's executive board, consisting of healthcare industry professionals, signs off on all new purchases and sales, providing a further level of oversight.

Market outlook: Fundamentals intact amid volatility

The fundamentals underlying progress in the biotech sector – major advances in the understanding of disease processes and human biology, a broadly accommodative regulatory regime and demand from ageing populations worldwide – remain intact. A sharp decline in the sector since the start of 2016, with the NASDAQ Biotech index underperforming broader indices in a falling market, has arguably been driven by a general rise in risk aversion. While the binary nature of drug success or failure means individual stock risk can be high, the sell-off may present an opportunity for investors to access the sector at lower share prices.

Valuation: Discount persists despite strong returns

In spite of strong medium-term performance, BION continues to trade at a discount to NAV of more than 10%, albeit narrower than the one-, three- and five-year averages of c 17-20%. This is wider than the average discounts of most UK-listed peers (see page 8). To support the share price performance, the company employs a discount management programme, whereby 5% of market capitalisation is distributed as a 'dividend' and up to 5% of shares are bought back annually.

Investment companies

9 February 2016

Price CHF227.0
Market cap CHF2,690.0m
AUM CHF3,001.7m

NAV* CHF253.3
 Discount to NAV 10.4%

*Including income. Data at 3 February 2016.

Yield 6.4%
 Ordinary shares in issue 11.85m*
 Code BION

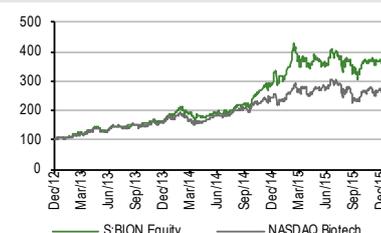
Primary exchange Zurich
 AIC sector N/A

*Five-for-one stock split proposed, new total would be 59.25m.

Share price/discount performance



Three-year cumulative perf. graph



52-week high/low CHF351.3 CHF225.2

NAV** high/low CHF403.6 CHF253.3

**Including income.

Gearing

Gross* 0.2%

Net* 0.2%

*As at 30 September 2015.

Analysts

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Exhibit 1: Investment 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% of the portfolio is invested in listed companies, primarily large and 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

■ 22 January 2016: Release of results for the fourth quarter of 2015. NAV increased by 14.7% in CHF (15.0% in €; 11.6% in US\$) and share price increased 12.6% in CHF (12.5% in €; 9.6% in US\$) compared with 11.8% for the benchmark NASDAQ Biotech index (in US\$).

Forthcoming

AGM	March 2016
Annual results	February 2016
Year end	31 December
Dividend paid	March (part capital return)
Launch date	November 1993
Continuation vote	None

Capital structure

Ongoing charges	1.1%
Gearing	0.2%
Annual mgmt fee	1.1% on market cap
Performance fee	None
Trust life	Indefinite
Loan facilities	See page 7

Fund details

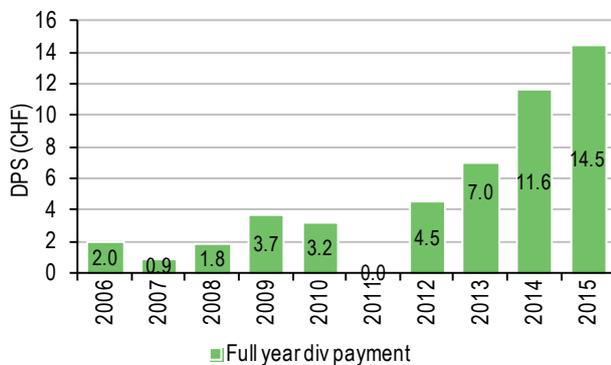
Group	Bellevue Asset Management
Managers	Team-managed
Address	Seestrasse 16, 8700 Kusnacht, Switzerland
Phone	+41 (0)44 267 6700
Website	www.bbbiotech.com

Dividend policy and history

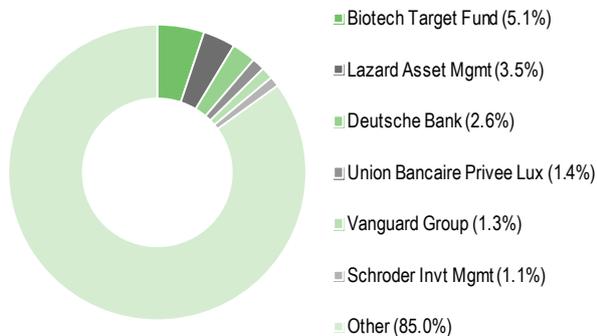
A new distribution policy was put in place from the year ended 31 December 2012, whereby BION makes a cash distribution equivalent to approximately 5% of its share price at the year end.

Share buyback policy and history

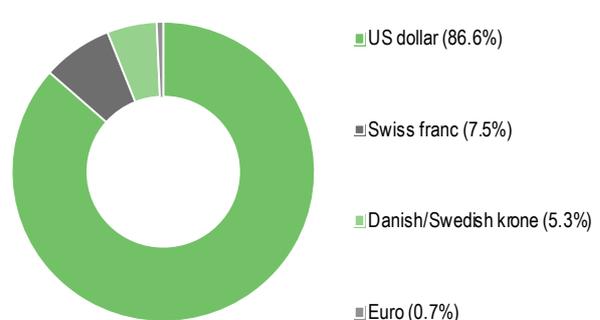
BION has authority, renewed annually, to repurchase up to 10% of its issued share capital. As part of the distribution policy announced in 2012, BION has also committed to returning 5% of its share price at the year end via the share buyback programme during the year.



Shareholder base (as at 30 November 2015)



Analysis of portfolio by currency (as at 31 December 2015)



Top 10 holdings (as at 31 December 2015)

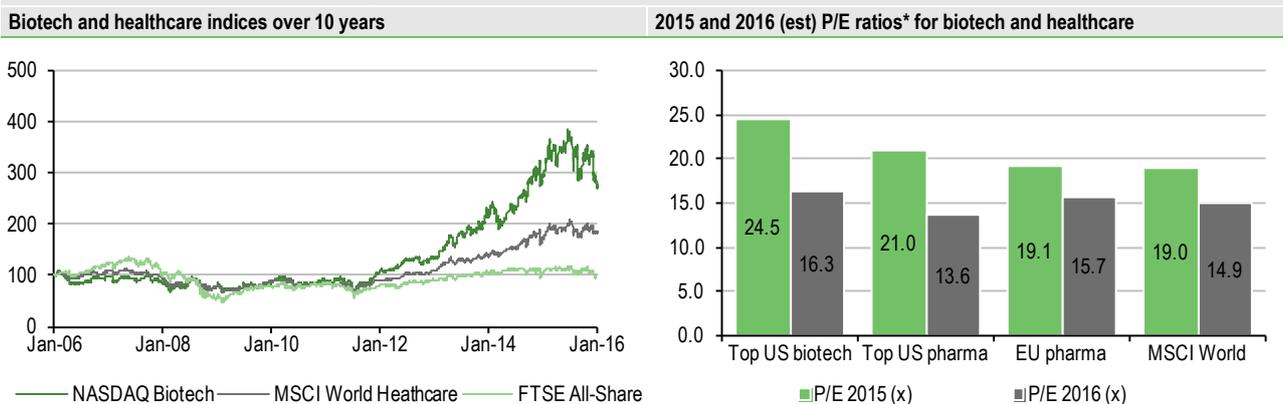
Company	Country of listing	Main clinical focus	Portfolio weight %	
			31 December 2015	30 June 2015*
Celgene	US	Oncology	10.5	9.8
Incyte	US	Oncology	9.9	9.3
Ionis Pharmaceuticals**	US	Genetic diseases	9.8	8.1
Actelion	Switzerland	Cardiovascular diseases	7.5	7.2
Gilead	US	Infectious diseases	6.8	7.6
Radius Health	US	Women's health	6.4	6.3
Alexion Pharmaceuticals	US	Orphan diseases	4.8	N/A
Neurocrine Biosciences	US	Women's health	4.3	3.7
Vertex Pharmaceuticals	US	Orphan diseases	4.2	3.9
Agios Pharmaceuticals	US	Metabolic disorders	3.4	5.3
Top 10 (% of portfolio)			67.6	64.7

Source: BB Biotech, Edison Investment Research, Morningstar, Bloomberg. Note: *N/A where not in June 2015 top 10. **Formerly Isis Pharmaceuticals, renamed in December 2015.

Outlook: Fundamentals intact against riskier backdrop

Renewed political pressure on drug pricing saw biotech stocks sell off in September/October 2015 before rebounding in the fourth quarter, and falling sharply again as 2016 opened in volatile mood across global markets. Biotech has significantly outperformed broad market indices and the healthcare sector over the past five years, yet valuations remain broadly comparable (Exhibit 2). The NASDAQ Biotech index fell 21.8% in total return terms during January in spite of a lack of specific negative newsflow, implying a ‘flight to safety’ or a change in investor sentiment. Fundamentals – the pace of scientific discovery, coupled with ageing populations worldwide requiring treatment – largely remain intact, however, so there is arguably scope for the upward trend of the past three years to resume, albeit perhaps at a slower pace.

Exhibit 2: Market valuation and performance



Source: Thomson Datastream, Edison Investment Research, BB Biotech, MSCI. Note: *Sector P/Es are mean of largest stocks.

Fund profile: Investing in biotech innovation

BB Biotech (BION) was launched in Switzerland in 1993. It is listed on the Swiss SIX exchange, with secondary listings in Germany and Italy. BION seeks capital growth by investing in the fast-growing biotechnology sector and holds a concentrated list of 20-35 stocks. Five to eight ‘core holdings’ account for as much as half the portfolio. Holdings are primarily in companies that already have products on the market, although the fund also invests in those with promising earlier-stage candidates. Unquoted firms may account for up to 10% of the portfolio. BION has a bias to US-listed companies (87% at 30 September 2015), with most of the balance in Northern Europe.

BION has been managed since launch by a specialist team at Bellevue Asset Management, led by Dr Daniel Koller and based mainly in Zurich and New York. The management team includes qualified doctors with various specialisms, as well as biochemists, molecular biologists and economists. It is overseen by an executive board of healthcare industry veterans. Since December 2014 BION has been a constituent of the Stoxx Europe 600 index of leading European companies.

The fund manager: Bellevue Asset Management

The manager’s view: Focus on fundamentals amid the noise

The biotech sector was hit by a broad sell-off in September, precipitated by comments from US presidential hopeful Hillary Clinton about pricing in the sector. During the fourth quarter, BION’s managers met with several US companies and found they were addressing the mood in the market practically, ensuring they had readily available pharmacoeconomic arguments to accompany any

changes in data. However, lead manager Daniel Koller stresses that BION is positioned for clinical outcomes, not political noise. Oncology, orphan diseases and infections remain attractive areas of revenue growth as advances in medical understanding allow unmet needs to be addressed. Koller notes that the pricing debate favours differentiated drugs rather than 'me-too' products, meaning there will be a further push for innovation as biotech companies look to maintain margins.

Newsflow was muted in H215, with developments including the approval of Alexion's Kanuma for a rare genetic enzyme disorder and, on the downside, negative data readouts from antibiotic specialist Tetrphase and Clovis Oncology. Koller says such negative events underscore the importance of having a diversified portfolio, given that news-driven share price movements can be extreme.

The market backdrop recently has been more volatile for small and mid-caps, with some stocks seeing large downward moves even without negative clinical data. After several years of strong performance, the manager notes that some investors may have seen a rise in volatility as an excuse to take profits. However, while there may be fewer investors prepared to buy on the dips, Koller says the September/October setback enabled BION's managers to speak to several potential investors who had been waiting for a more favourable entry point.

In terms of the outlook, Koller says the team is maintaining a cautious stance, expecting more differentiated performance from biotech companies in the year ahead. With big biotech having seen P/E multiples shrink to the extent that valuations are now on a par with 'big pharma' and the US market as a whole, there is scope for the larger players to outperform through re-rating, while for smaller stocks performance is likely to be data-dependent. Data readouts and product approvals will accelerate through 2016 and M&A may also pick up again, having been muted in the second half of 2015. While the macro environment – including the US election and the divergence in monetary policy between the US and the rest of the world – may add volatility, BION's managers believe their blend of established and growing players has scope to perform well and, consequently, they have moved from a net cash position in summer 2015 to a marginal (c 0.2%) level of gearing.

Asset allocation

Investment process: Four steps to clinical success

BION's managers follow a four-stage investment process, beginning by developing themes based on clinical and technological innovations. This helps to filter the universe of 800+ biotechnology stocks globally. The investment professionals at Bellevue Asset Management are specialists with a variety of clinical focuses and use industry conferences, scientific literature and meetings with medical professionals and sector analysts to ensure they are up to date with developments.

The thematic filter narrows the universe to c 300 companies, to which quantitative and qualitative tests are applied to reach a long list of c 100 stocks, with the team building in-depth financial models for each. Screening criteria are weighted towards clinical considerations such as efficacy of new treatments, but other factors such as financial strength and management quality are also important.

Stocks emerging from this process are discussed by the team (based on detailed proposals drawn up by Bellevue's analysts) and presented to the executive board at monthly meetings. The proposals include clinical data, financial models, an estimate of upside and downside and recommendations on position size and purchase price. While the board has the final say on new positions, complete exits and major changes in weightings, the managers have autonomy in day-to-day portfolio management.

The end result is a portfolio of 20-35 stocks, with five to eight core positions accounting for around half of assets. The managers seek a spread of market capitalisations, with a significant number of the holdings in smaller and mid-caps, although there is a bias towards companies that are already generating above average sales and profit growth.

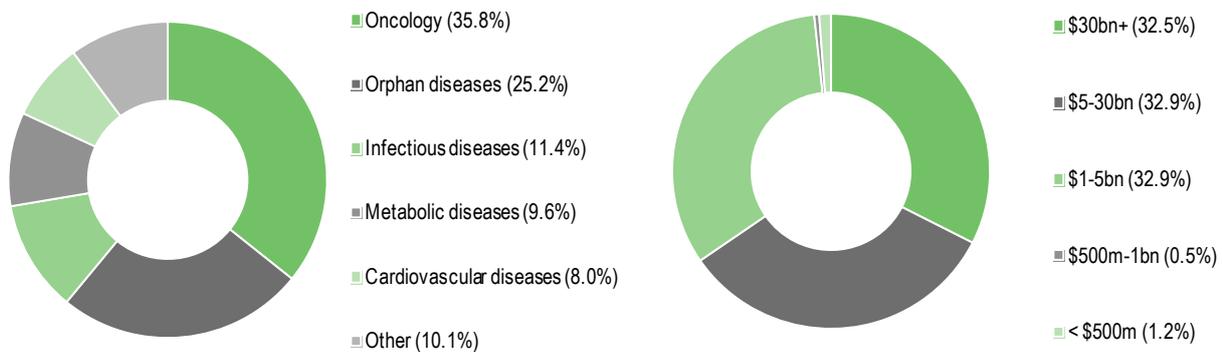
Current portfolio positioning

At 31 December 2015 BION had 34 equity holdings, the shortest stock list in its peer group (see Exhibit 8), where the average is c 60. The top 10 holdings account for more than two-thirds of the portfolio (67.6%), with 50.9% of assets invested in six core holdings: Celgene, Incyte, Ionis (formerly Isis) Pharmaceuticals, Actelion, Gilead and Radius Health.

From a clinical perspective, the largest sector exposure is to oncology (the main focus of the top two holdings), with orphan diseases the next largest weighting. A significant minority of assets is invested in companies focused on infectious diseases (novel antibiotics as well as the blockbuster hepatitis C assets of Gilead) and metabolic/endocrine disorders.

The portfolio has broadly equal proportions invested in small to mid-cap, mid to large-cap and mega-cap stocks. The core holdings tend to be larger, with the average market capitalisation of the top six holdings standing at \$41bn, although sixth-placed stock Radius Health is relatively small at c \$2bn. Radius has joined the top tier of stocks following a period of strong performance on the back of positive Phase III data for its osteoporosis treatment abaloparatide, which has seen it move up from the small-cap to the mid-cap segment.

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



Source: BB Biotech, Edison Investment Research, at 31 December 2015

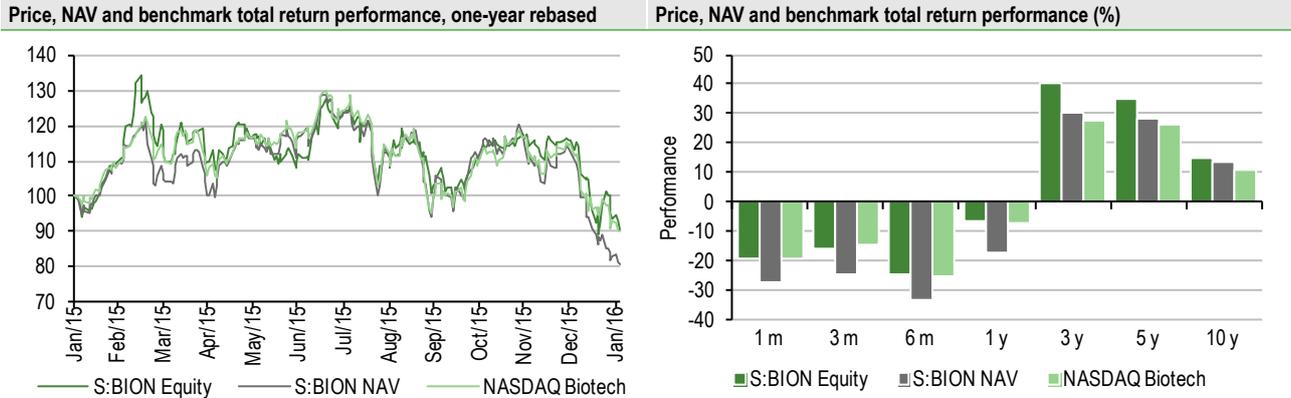
There have been incremental changes to the portfolio throughout the year, with five stocks sold (three were the subject of M&A activity: Synageva, Receptos and Pharmacyclics, and the small holdings in Theravance/Theravance Biopharma were sold in Q3) and eight added, at a rate of two per quarter. The most recent additions were Esperion and Prothena (respectively focused on cholesterol reduction and the protein disorder amyloidosis) in Q3, and Sage Therapeutics (central nervous system disorders) and Cidara Therapeutics (anti-infectives) in Q4.

The managers note that they are increasingly focused on primary care/GP end-markets, where there is higher volume and lower pricing, giving a degree of insulation from the political pressure on the pricing of new drugs for more specialist indications. This has led to a higher weighting in metabolic/endocrine disorders, including diabetes and women's health issues such as endometriosis and osteoporosis, as well as cardiovascular indications including hypercholesterolemia.

While the stock list is currently at the top end of BION's target range of 20-35, the managers says it is unlikely to exceed this number even though more volatile market conditions may have led to ideas of stocks to buy outnumbering those to sell. With many of the smaller companies, data readouts are relatively far in the future, which makes them more prone to discounts and thus better viewed as long-term holdings. Most of the new holdings in 2015 have been in the \$1-5bn segment, where the managers see an appropriate balance of risk and return potential.

Performance: January sell-off hits short-run returns

Exhibit 4: Investment company performance to 31 January 2016



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

Exhibit 5: Share price and NAV total return performance, relative to indices (%), to 31 January 2016

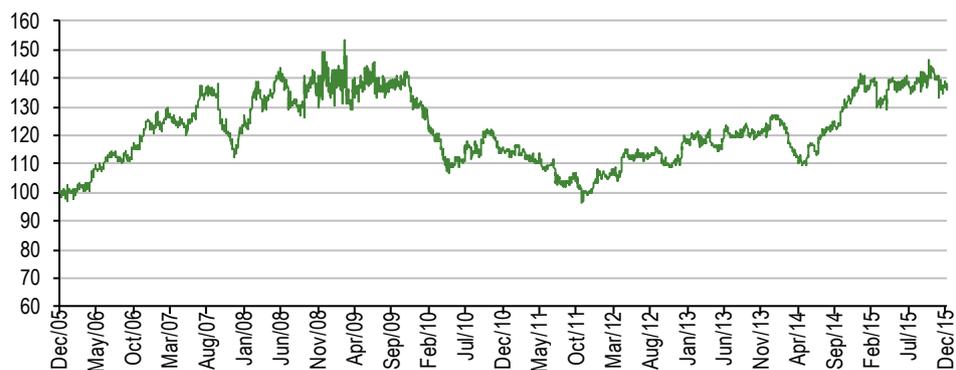
	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to NASDAQ Biotech	0.0	(1.1)	1.2	1.0	32.4	39.6	41.8
NAV relative to NASDAQ Biotech	(10.0)	(11.7)	(10.3)	(10.8)	6.2	9.8	26.6
Price relative to MSCI World Health Care	(14.3)	(12.7)	(17.5)	(12.7)	64.0	95.2	112.4
NAV relative to MSCI World Health Care	(22.8)	(22.1)	(26.9)	(22.9)	31.4	53.5	89.6
Price relative to FTSE All-Share	(15.3)	(8.1)	(16.0)	(6.5)	144.0	251.6	279.8
NAV relative to FTSE All-Share	(23.7)	(18.0)	(25.6)	(17.4)	95.6	176.6	239.1

Source: Thomson Datastream, Morningstar, Edison Investment Research. Note: Performance calculated in CHF. Geometric calculation.

Having been one of the standout areas of stockmarket performance in recent years, the biotech sector fell back from mid-2015, with a further sharp leg downwards in January 2016. The NASDAQ Biotech index fell 21.8% in January alone and BION's NAV underperformed the benchmark, with a weighted average share price fall of 27.8% for the fund's top 10 holdings exacerbated by larger falls for the smaller stocks that predominate in the remainder of BION's concentrated portfolio. While wobbles in the second half of 2015 centred on political pressure over drug pricing in the US and some company-specific issues such as disappointing data readouts from Tetrphase and Clovis Oncology, the falls in early 2016 look to have been largely sentiment driven, with little newsflow.

While the sell-off has hit shorter term performance in both absolute and relative terms, BION retains its record of NAV and share price total return outperformance of the benchmark NASDAQ Biotech index (in CHF terms), the wider healthcare sector, as well as mainstream equities (the FTSE All-Share is included as a comparator because of its relevance to UK investors) over periods of longer than one year (Exhibit 5).

Exhibit 6: NAV performance relative to NASDAQ Biotech index over 10 years

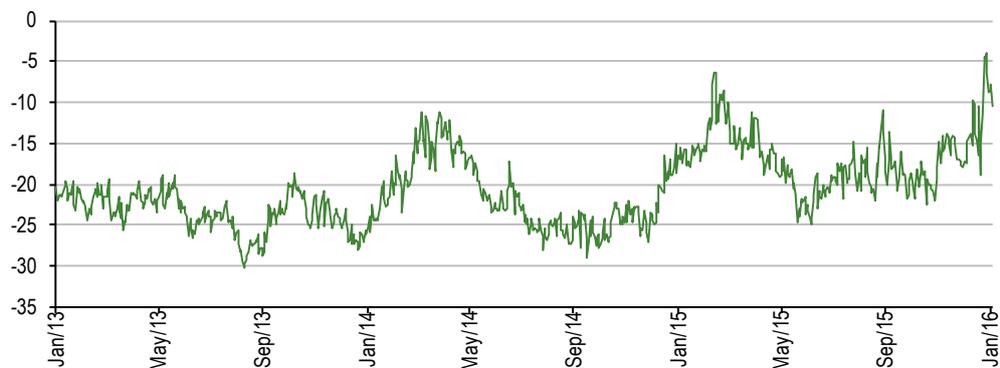


Source: Thomson Datastream, Morningstar, Edison Investment Research

Discount: Volatile but narrowing over longer term

BION continues to trade at a wider discount to NAV than most of its UK-listed peers (see Exhibit 8), although narrower than its compatriot HBM Healthcare. The 3 February cum-income discount of 10.1% was smaller than the one-, three- and five-year averages of 16.9%, 20.6% and 20.5% respectively, although wider than the five-year low point of 6.4% reached in March 2015. A narrowing from late January was largely the result of the NAV falling by more than the share price. BION seeks to manage its discount using the capital distribution policy set out below, and a share buyback programme whereby c 5% of shares are repurchased into treasury each year (these may be reissued according to demand). In the first nine months of 2015 a net CHF45.9m worth of shares was bought back. BION does tend to suffer some discount volatility at times when biotech stocks are less favoured but a narrowing trend is evident, particularly over longer periods.

Exhibit 7: Discount over three years, including income



Source: Thomson Datastream, Morningstar, Edison Investment Research

Capital structure and fees

BION is listed on the Swiss SIX exchange as a closed-ended company and has secondary listings (priced in euros) in Germany and Italy. There are 11.85m shares in issue, of which 126,995 were held in treasury at 30 September 2015 (a 63.5% increase on the figure at the start of 2015). In recognition of significant share price gains in recent years, a five-for-one stock split has been proposed, which would see the number of shares in issue rise to 59.25m.

Borrowing is available via a bank loan, of which CHF60m was drawn at 30 September 2015 (up from CHF30m at the start of the year), representing net gearing of c 0.2%.

BION's manager, Bellevue Asset Management, receives an all-in annual fee of 1.1% of average market capitalisation. Uniquely among its peers, BION does not charge a performance fee. The stated total expense ratio at 30 September 2015 was 1.13%, down from 1.14% at the end of 2014.

Dividend policy and record

Because their businesses are often at an early stage of development, few biotech companies pay a dividend. However, as part of its discount management policy, BION seeks to return c 5% of market capitalisation to shareholders each year by way of a capital distribution (5% of the volume-weighted average share price in December of each year). A distribution of CHF14.50 per share was declared for FY15, representing a yield of 6.4% based on the 3 February 2016 share price of CHF227.0. This is an increase of 25% on the previous year's distribution. Since the adoption of the discount control mechanism at the end of 2012, distributions have grown at an annualised rate of 34.0%.

Peer group comparison

Exhibit 8 below shows a peer group made up of the four UK-listed biotech and healthcare funds (two of each), as well as Switzerland-listed BION and HBM Healthcare (all data in CHF terms). BION is the largest of the group. It ranks second for NAV total returns over three and five years, but is sixth of six over one year, after a sharp biotech sell-off in January. Over one year it is ranked sixth for risk-adjusted performance as measured by the Sharpe ratio, rising to fourth over three years. BION has the highest yield in the group, although this is a function of its policy of returning 5% of capital as a 'dividend' rather than reflective of portfolio income. Ongoing charges are in line with the weighted average for the sector and BION is the only fund not to charge a performance fee. Its discount is the third widest in the peer group.

Exhibit 8: Biotech and healthcare peer group (in CHF terms)

% unless stated	Market cap €m	TR 1 year	TR 3 year	TR 5 year	Ongoing charge	Perf. fee	Discount (-)/prem	Net gearing	Dividend yield (%)	Sharpe 1y (NAV)	Sharpe 3y (NAV)
BB Biotech AG	2,662.4	(17.1)	121.5	248.2	1.1	No	(10.4)	101.0	6.4	(0.8)	1.1
Biotech Growth Trust	518.3	(9.2)	107.8	261.6	1.2	Yes	(7.6)	114.0	0.0	(0.6)	1.1
HBM Healthcare Investments AG	770.0	18.7	171.6	162.1	1.7	Yes	(32.8)	100.0	5.5	0.4	1.6
International Biotechnology Trust	233.4	(6.0)	103.3	182.9	1.7	Yes	(14.6)	100.0	0.0	(0.5)	1.1
Polar Capital Gbl Healthcare	293.1	4.4	47.8	99.7	1.1	Yes	(4.3)	100.0	2.2	(0.5)	1.1
Worldwide Healthcare	1,161.2	4.9	97.4	159.8	1.0	Yes	(7.7)	110.0	0.8	(0.2)	1.4
Peer group weighted average		(5.4)	117.5	209.1	1.2		(12.5)	103.8	4.7	(0.5)	1.2
BION rank in peer group	1	6	2	2	4		4	3	1	6	4

Source: Morningstar, 4 February 2016 (performance to 31 January). Note: TR = NAV total return. Sharpe ratio is a measure of risk-adjusted return. The ratios shown are calculated by Morningstar for the past 12- and 36-month periods by dividing a fund's annualised excess returns over the risk-free rate by its annualised standard deviation. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared). *BB Biotech's yield is a function of its 5% capital distribution policy. Few biotech stocks pay dividends.

The board

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

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