BB Healthcare Trust

Monthly News
July 2019

As at 07/31/2019	Value	1 Month (July)	YTD	Since Launch (ITD)
Share	135.50	0.3%	17.1%	45.4%
NAV	134.08	-1.4%	17.2%	46.6%

Sources: Bloomberg & Bellevue Asset Management AG, 31.07.2019, NAV and share price returns are adjusted for dividends paid during the period (but not assuming reinvestment)

Note: Past performance is not a guide to future performance. The value of an investment and the income from it may fall as well as rise and is not guaranteed.

Welcome to our July update. In a world of 'clicks' and 'likes', where the subtle art of messaging and 'good PR' is paramount, a press release from a pharma or biotech company entitled "[company] provides update on [drug trial]" generally portents a top-line failure and some attempt to salvage something from the situation with a spurious sub-group analysis. Although we always include the word "update" in our introduction, the comparison is not lost on us this month…

Throwing pearls to pigs

Without a shadow of doubt, the summer of 2019 has been our most painful period in terms of relative performance and from a perspective of digesting market reactions to news flow. We can but hope that July is the nadir.

Let us get the numbers for the month out of the way and then move onto some more qualitative commentary. The Trust's dividend-adjusted net asset value declined 1.4% to an ex-dividend figure of 134.08p (the shares are trading ex the 2.425p FY19 interim dividend as of 25th July 2019). In contrast, the MSCI World Healthcare Index rose 2.7% in sterling terms (it declined 0.5% in USD). As such, we under-performed by 4.1% on a relative basis.

This lamentable performance was due primarily to two stocks; Illumina and Align, where the market has chosen to forsake longer-term indicators of health in favour of tangible, but shorter-term concerns. Those on the sell-side who have been longstanding bulls of these two stocks frequently cite all the proprietary analyses that underpin their theses.

We have our own such work and, when short-term issues cloud the picture, we try to frame the debate around what, if anything, has changed regarding those longer-term fundamentals. This time around, the sell-side's willingness to defend both these companies has been notably muted, instead perceiving fulminating risks, begging the question why the market is in such an unforgiving mood.

US macro-political concerns are undoubtedly a key factor. It was another busy month of healthcare news over the pond, as first we saw the Trump administration step back from its original drug pricing-related proposal to eliminate rebates in government programmes. Initially there was a relief rally across the drug supply chain, followed by some uncertainty as to where the Administration turns next in its goal to take a drug pricing "win" to the people ahead of the 2020 election. We continue to worry about investor complacency over the longer-term drug pricing outlook.

Rather than focus negative attention on the Pharma/Biotech sub-sectors, all of the polemics seem to be inclining equity strategists advising investors to avoid healthcare entirely. This trend began in March amidst the Democratic proposals for "Medicare for All".

By way of illustration, the popular XLV ETF (which mimics the US S&P 500 Healthcare Index) saw a March volume high of 217m shares outstanding. Today that has declined to 190m, a 12% decline. In value terms, the amount invested into this ETF has shrunk from $19.3bn to $17.3bn. Healthcare is apparently not the place to be. The sector again underperformed the wider market, with the MSCI World Index rising 0.4% in dollar terms versus the healthcare sector declining 1.2%. Healthcare has now lagged the wider market for four consecutive months.

The sub-sector performance over the month (Figure one) again reflected this macro-driven approach, with Insurers (Managed Care), Hospitals (Facilities) and the drug supply chain (Distributors) reacting positively to the evolving political climate. Generics was spared further blushes somewhat by the positive reaction to Mylan's deal with Pfizer, otherwise it would have seen a double-digit decline for the month (Mylan has a 50% weighting). The Diagnostics and Dental sub-sectors were led lower by Illumina and Align (their respective sub-sector weightings are 44% and 70%).

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.

BENCHMARK SUB-SECTOR PERFORMANCE AND WEIGHTINGS

Sub-Sector	Weighting	Perf. (USD)	Perf. (GBP)
Biotech	9.4%	-1.7%	2.2%
Conglomerate	11.9%	-3.9%	-0.1%
Dental	0.6%	-18.5%	-15.3%
Diagnostics	2.4%	-8.1%	-4.5%
Distributors	2.8%	1.1%	5.1%
Facilities	1.2%	2.3%	6.3%
Generics	0.4%	-2.3%	1.5%
Healthcare IT	1.0%	1.6%	5.6%
Healthcare Tech.	0.3%	4.7%	8.8%
Managed Care	8.4%	3.9%	7.9%
Med-Tech	15.5%	2.8%	6.8%
Other Healthcare	1.2%	0.7%	4.7%
Pharma	33.5%	-2.3%	1.6%
Services	1.7%	-1.2%	2.7%
Specialty Pharma	3.6%	-1.0%	2.9%
Tools	6.0%	-4.0%	-0.2%

Source: Bloomberg/MSCI and Bellevue Asset Management. Weightings as of 30-06-19. Performance to 31-07-19.

Silk purses, or sow's ears?

It is a truism that passion makes fools of even the wisest. Whilst we would not pretend to be wise, we can be foolish. In last month's missive, we noted that July would bring "the Q2 reporting season and the hope of a re-focussing on fundamentals and some differential performance in terms of company quality". We got what we wished for and, as is often the case, we regretted asking for it.

Like the fabled pearls, those with shorter investment timeframes trampled our most coveted stocks underfoot in the rush to judgement. July, then, is very much a tale of two stocks. We thought it useful to remind readers why we own these two stocks at high weightings within the portfolio and what, if anything has changed in terms of our theses following their undeniably disappointing Q2 updates. Firstly, a reminder of the long-term investment thesis:

- **Align Technology.** This holding represented 8.3% of the portfolio's gross exposure as of the end of June. Align is the company behind Invisalign, a suite of clear aligner dental products. Aligners are a 3D-printed clear plastic alternative to metal braces for orthodontics. In addition to improved convenience and aesthetics, the technology has evolved to the point where it can compete with fixed appliances for a significant majority of malocclusions of the mouth.

  Align has a roughly 90% share of a market that is probably around 10% penetrated currently. The company expects (and we agree) that the market will grow >20% per annum for many years to come. Competition does exist, but is currently limited to a pool of patients with simple problems that maybe accounts for 5-10% of the overall market opportunity. 75% of the market is teens and penetration there is single digit.

Furthermore, the company has opened up new options for treatment in the very young (children who cannot practically have fixed braces) and complex cases such as jaw alignment (mandibular advancement) can now be treated in a minimally invasive way and the company expects to launch a mandibular expander product in the next few years as well. These newer tools carry significant IP protection that further grows the competitive moat, even as competition will eat into the simple cases over time. After all, there is only really one way for a >90% market share to evolve.

Given our focus on transformative approaches to healthcare problems that enhance patient experience and outcomes, whilst enabling physicians to make better treatment decisions, we cannot envisage a scenario in the medium-term where this would not be a holding for the Trust.

- **Illumina.** This holding represented 8.6% of the portfolio's gross exposure as of the end of June. Human health is inextricably linked to genetic activity; every process in your body is controlled by gene expression. The genetic traits that you inherit, and changes to your DNA in response to external factors, have a significant bearing on lifetime disease risk. The ability to analyse genetic information quickly and relatively cheaply underpins a revolution in diagnostics.

  At the macro level, one's healthcare journey should start with 'pre-diagnosis', i.e. active management of populations deemed to be at high risk of progressing to a serious chronic medical condition and such health screening is increasingly popular.

  Similarly, diagnosis and treatment planning is increasingly accommodating genetic data, to know what mutations make your cancer susceptible to treatment, what pathogen is infecting you and thus how to kill it or which genes have been turned on to understand the pathology of your symptoms or treatment side effects.

  Again, this sort of data sits squarely at the heart of our focus on transformative approaches to healthcare problems that enhance patient experience and outcomes, whilst enabling physicians to make better treatment decisions. Whilst it is fair to say that the list of companies developing diagnostic tools and services around genetic screening is very large, the background screening that enables their existence or underpins how they work uses Illumina technology. It is akin to the Microsoft Windows of the genetic age and we think it is a good idea to own the picks and shovels supplier through this genetics gold rush.

  An increasing role for genetic-based diagnostics in the practice of medicine is one of our key themes on a 10-year view and we see Illumina as retaining its significant lead as the #1 provider of the hardware and software to facilitate this. 2017 was a watershed year for the company as its new 'NovaSeq' platform is enabling the cost of whole genome sequencing to fall to levels that make it comparably inexpensive to other routine diagnostic tests and thus usher in a period of significant growth for the overall platform.

Hopefully, the brief descriptions above provide some understanding as to why we view these two companies as core positions. We are very focused on the 3-5 year investment time horizon and see these companies as sustainable teens or better growth stories over that period.

Rarely do things evolve in straight lines and there are inevitably twists and turns (a sight too many in recent weeks, but such is the nature of investing). We have included a brief summary of what transpired with the Q2 updates from both companies and a brief explanation of why we believe the core investment thesis outlined above remains intact:

- **Align Technology.** The company guides one quarter ahead on group revenues, case shipments (volume) and operating margins (given its flexibility over promotional spending). It At Q1, it guided for Q2 case volumes of 380-385k and $590-600m in revenues, with a margin corridor of 24.5-25.4%.

  Align reported Q2 results on 24th July. Case volumes were 377k, around 1% below the bottom of its guidance range and 2% below the top. This is the first time that the company has not exceeded its guided range that we can recall. Growth was ahead in Europe but behind in China and the US. Pricing (ASP/aligner) was as expected (recall, this was the concern that blighted the Q3 18 results). The shortfall in China was attributed to consumer sentiment issues, which may be short-term in nature. In the US, there was some loss of share to competition in the non-teen, non-complex case area (to low cost options like Smile Direct Club).

  Whilst competitive pressure has been expected for some time, this was the first period that management flagged it specifically as having an impact. Promotional giveaways (we think from the likes of Straumann) compounded these issues. Despite the case volume shortfall, overall revenues were at the top end of the range owing to positive scanning revenues.

  On the guidance for Q3, the company guided 370-380k cases, $585-600m in revenues and margins of 19.8-20.5%. Prior to the results, revenue consensus was around 5-6% higher than the upper end of the guide. It is unarguable that the Q3 outlook is disappointing. However, one must contextualise this: management flagged specific issues with regard to forecasting China (the fastest growing market in Q1 19) and have taken a haircut to numbers to reflect this. They also assume scanning revenues will decline, having been so strong in H1 19.

  In the longer-term, the leading forward growth indicators of scanners sold (it is only worth buying a scanner if you plan to do a reasonable case volume moving forward) and doctors trained on the scanning and software platform were well above expectations again. The company reiterated its long-term revenue growth guidance at 20-30%.

  Bringing this all together, we have the emergence of long-expected competition, a c.2% miss on the quarter and a short-term revenue guide that is intentionally conservative. Promotional activity from competitors will subside, Align has guided for higher promotional spend as a counterweight in any event and the long-term market growth opportunity remains vast. The question, then, is whether this really merited a 30% decline in the share price over the next few days. We have been buying more shares since the results.

- **Illumina:** the company pre-announced Q2 results on 11th July, with full results on 29th July. It goes without saying that the pre-announcement was a negative surprise. Q2 revenues fell ~$50m or 7% short of expectations. This was attributed to various factors, but most notably ~$30m due to a slippage in the start of various population genomics initiatives and ~$10m lower direct-to-consumer sales (e.g. Ancestry.com and 23andMe). NovaSeq shipments were said to be ahead of expectations, which should be a positive forward indicator in terms of revenue growth.

  In isolation, the above would probably be more than manageable given the "slippage" comment. However, the more surprising thing was the cutting of the FY19 guidance. Prior to Q2 results, the company was guiding for 13-14% revenue growth, with gross margins flat to slightly down and operating margins to improve approximately 2% versus 2018. This was revised to revenue growth of ~6%, gross margins declining ~125bp and operating margins to improve around 125bp. Given the obvious market growth opportunity, this newfound humility regarding the near-term financial opportunity is hard to reconcile.

Those of us hoping that the 29th July conference call with management would clarify the situation were left more confused than before. On the plus side, the overall comments regarding the marketplace, customer sentiment and longer-term growth prospects were positively effulgent. Again, this rather begs the question why the outlook has changed so much. The answer seems to be uncertainty over timing for key customer projects, where again detailed explanations for timeline slippages were offered on the call.

The shape of the guidance for Q3 and H2 implies a very Q4-weighted sales pattern and this may well reflect such uncertainty. This guidance also appears to have been stripped of any assumptions regarding growth in the 'direct to consumer' channel. We see risk to the upside around Q3 results but likely no increase to full-year guidance if such projects do start earlier than now anticipated.

As with Align, we see this as a temporal speed bump on an otherwise compelling journey that does not justify a >20% move in the share price and have added to our position since the results pre-announcement.

Developments within the Trust

Buffeted as we were by the unyielding macro headwinds and incendiary climate for poor results, trading activity has been muted. The portfolio remains unchanged in terms of holdings (28 stocks in the portfolio), although we have re-weighted the book in favour of some of the laggards, where we see little fundamental reasons for divergent performance over recent weeks.

As noted above, the shares are now trading ex with respect to the interim dividend (2.425p/share), which is expected to be paid on August 30th. We published a scrip dividend circular on 24th July (which is available on the BBH website), allowing shareholders to elect to receive new shares instead of cash.

Certificated shareholders who wish to elect for the scrip dividend alternative can do so online at https://www.signalshares.com or a mandate form can be obtained by contacting the Company's registrar, Link Asset Services on +44 (0) 371 664 0321. Uncertificated Shareholders can make an election via the CREST system. Shareholders have until 5pm on the 9th August to make an election; no action needs to be taken if they wish to continue to receive dividends in cash.

As noted last month, it was our intention to reduce the leverage ratio. However, a decline in absolute net borrowings was offset by the deterioration in the gross value of the portfolio, so the ratio stands at 8.7% (excluding cash set aside for the upcoming dividend) versus 7.5% at the end of June. We issued a further approx. 6m additional shares through the tapping programme.

We thank you all for your continued support of the Trust. We always appreciate the opportunity to interact with our investors directly. We would remind readers that they can submit questions regarding the Trust at any time via: shareholder_questions@bbhealthcaretrust.co.uk

As ever, we will endeavour to respond in a timely fashion.

Paul Major and Brett Darke

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Standardised discrete performance (%)		
12-month total return	**July 18 - July 19**	**Dec 16 - July 19***
NAV return (inc. dividends)	6.4%	46.6%
Share price	1.5%	35.5%
Share price (inc. dividends)	6.3%	45.4%
MSCI WHC Total Return Index	11.0%	40.8%

Sources: Bloomberg & Bellevue Asset Management AG, 31.07.2019

NAV return and share price returns are adjusted for dividends paid during period where started (but not assuming reinvestment)

*Trust incepted on 2 December 2016. Therefore 12 months of perfromance data does not exist for the calendar year.

Note: Past performance is not a guide to future performance. The value of an investment and the income from it may fall as well as rise and is not guaranteed

SUB SECTOR BREAKDOWN

Managed Care	18.1%
Diagnostics	14.0%
Biotech	12.4%
Healthcare IT	12.3%
Med-tech	11.0%
Specialty Pharma	9.6%
Dental	8.0%
Pharma	5.3%
Services	5.0%
Facilities	2.2%
Health Tech	2.1%

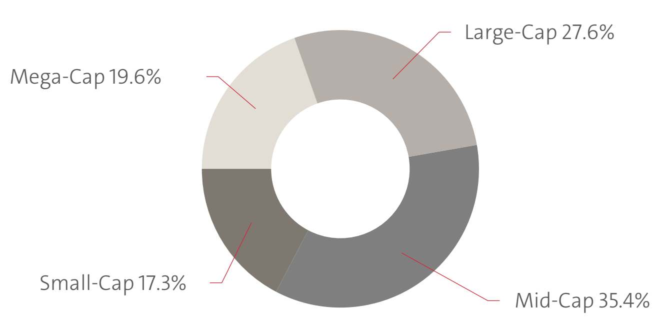
Source: Bellevue Asset Management, 31.07.2019

TOP 10 HOLIDINGS

Teladoc	10.1%
Anthem	10.0%
Align Technology	8.0%
Illumina	7.5%
Humana	7.1%
Bristol Myers Squibb	5.3%
Lonza	5.0%
Intuitive Surgical	3.4%
Hill-Rom Holdings	3.0%
Esperion	2.9%
Total	**62.2%**

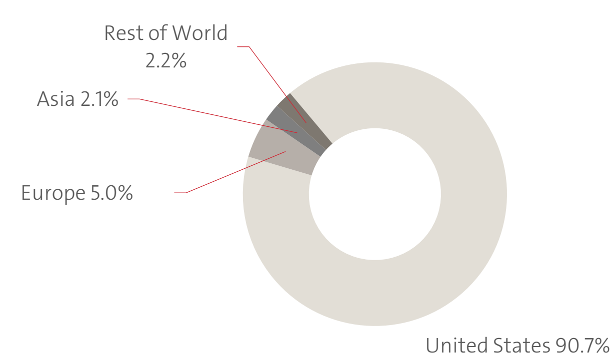
Source: Bellevue Asset Management, 31.07.2019

MARKET CAP BREAKDOWN



Source: Bellevue Asset Management, 31.07.2019

GEOGRAPHICAL BREAKDOWN (OPERATIONAL HQ)



Source: Bellevue Asset Management, 31.07.2019

"two companies representing ~5% 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 targets a dividend payout equal to 3.5% of the prior financial year-end NAV
- BB Healthcare has an experienced management team and strong board of directors

MANAGEMENT TEAM


Paul Major


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 688.5 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	414 917 593
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 two equal instalments
Fee structure	0.95% flat fee on market cap (no performance fee)
Discount management	Annual redemption option at/close to NAV

DISCLAIMER

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