# Platinum International Health Care Fund

**Bianca Ogden** Portfolio Manager

## Disposition of Assets

| REGION | SEP 2014 | JUN 2014 |
|---|---|---|
| Europe | 49% | 46% |
| North America | 29% | 25% |
| Japan | 5% | 6% |
| Australia | 1% | 1% |
| South America | 1% | 1% |
| Cash | 15% | 21% |
| Shorts | 1% | 0% |

Source: Platinum. Refer to Note 3, page 4.

## Performance and Changes to the Portfolio

**(compound pa, to 30 September 2014)**

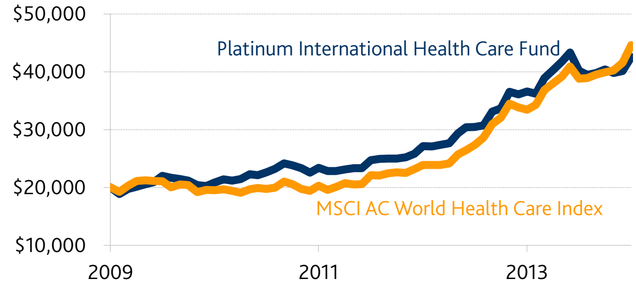
| | QUARTER | 1YR | 3YRS | 5YRS | SINCE INCEPTION |
|---|---|---|---|---|---|
| Platinum Int'l HC Fund | 5% | 16% | 22% | 16% | 8% |
| MSCI AC World HC Index | 12% | 33% | 30% | 17% | 8% |

Source: Platinum and MSCI. Refer to Note 1, page 4.

US biotechs continue their almost unabated rise. Large biotechs such as Gilead make up large positions of the Index and dominate its performance. While the Fund has held Gilead in the past and currently holds other US biotechs, the Fund is a lot more diversified and our positions are less extreme. Taken together with our cash position and, until recently, the resilience of the Australian dollar, the performance of the Fund has been held back.

**Value of $20,000 Invested Over Five Years**

*30 September 2009 to 30 September 2014*




Source: Platinum and MSCI. Refer to Note 2, page 4.

Nonetheless, we do struggle to make sense of US valuations and remain selective, staying away from companies we feel are already priced for perfection. Take Gilead; the company continues to remain a market favourite (advanced over 28% this quarter and over 60% for the year). We have a lot of respect for the company and likely picked it early as the Hepatitis C virus (HCV) winner. However, Gilead is now valued at $161 billion, with $25 billion in revenue this year, half of which is from its HCV drug. Given the leverage, 70%+ of sales will translate into operating profit. Expectations are for this leverage to continue and to further improve. We struggle to find a company that has maintained such operating margins for several years. To us this scenario is far too optimistic, given more intense pricing pressures, competitive HCV drug launches and generics to Gilead's HIV drugs. This quarter we added a biotech index short.

We see AstraZeneca as a much better proposition. AstraZeneca is valued at $90 billion with a lot of opportunities ahead (regardless of Pfizer's overtures). Its late stage pipeline has doubled over the past 18 months, its respiratory franchise has been nicely strengthened via sensible and reasonably priced deals; Brilinta AstraZeneca's anti-platelet drug is indeed making progress in the US and the diabetes product portfolio is now ready to grow. No doubt patent expirations will have a short-term effect on earnings but AstraZeneca has a whole new product cycle (from not just one product) ahead of it. Similarly, Sanofi a company that is finally getting some recognition for its pipeline as it also embarks on its new cycle. This quarter we added to both holdings.

This is what we do; we look for opportunities that often have suffered temporary setbacks or have to re-adjust themselves. This has taken us to Europe. Here, several of our biotech holdings did well for the year; UCB, BTG, Actelion all advanced 60-80%. The US has been weaker for us as the market's mantra has been to support proven winners rather than neglect.

During the quarter we started to trim our Shire Pharma holding in anticipation of the Abbvie/Shire acquisition. This was a cash/share deal, partly motivated by tax benefits but also to gain access to Shire's products and pipeline. At this stage we are not yet convinced that Abbvie is a good investment opportunity. We added the German-US dialysis provider Fresenius Medical Care (FMC) to our portfolio. While FMC was a longstanding favourite not long ago, reimbursement changes have made life more difficult. This is now more or less behind us and we believe that FMC is taking the necessary steps to adjust to the new norm. Furthermore, there will also be changes to the cost of dialysis drugs that are still not as well-understood by the market.

## Commentary

Japanese pharmaceutical companies are going through similar issues as their global peers experienced several years ago, although Japanese companies are unable to execute aggressive restructuring at home. The home market is tough with regular price cuts, slow sales growth and a lot more generics than ever before which makes life challenging. Add the expiration of overseas patents and things look pretty bleak. The Fund owns a number of Japanese pharmaceutical companies, with Astellas being an example of how best to achieve a turnaround. Daiichi Sankyo on the other hand is the clear example of how not to restructure. That said, the company now has a second chance and given its low valuation cannot be ignored. Changes in Japan started off in earnest with consolidation among Japanese pharmaceutical companies, followed by acquisitions overseas, licensing deals and some internal pipeline successes. Astellas has been smart on all fronts, while Daiichi Sankyo got some of it spectacularly wrong, although other efforts are still to pay off. Looking back, Astellas' efforts at the time were not clear cut and it is with hindsight that this company has morphed into a much more western-style pharmaceutical company.

In 2009 the company entered a licensing deal with Medivation for a new prostate cancer drug. Subsequently, Astellas paid a lot of money for OSI Pharma, a deal that made us happy as we were OSI shareholders, though in general, raised eyebrows. OSI's lung cancer drug was already partnered with Roche (who would have been the natural contender) and so all that Astellas got was co-promotion rights in the US and royalty payments from Roche elsewhere in the world. In the end, however, Astellas won a US oncology sales force and a very valuable cash flow cushion at times of patent problems.

Conversely, the Medivation alliance, has been a lot more powerful since Xtandi (prostate cancer drug) emerged as a real drug. We are now seeing profit growth return and it is time to reassess what will be the next pillar. Again, Astellas has been a smart deal maker, it has in-licensed a number of drugs (e.g. from Fibrogen), it has set up a joint venture with Amgen that provides access to Amgen's pipeline (e.g. PCSK9 antibody for lowering cholestrol) and it has also out-licensed drugs (e.g. JAK inhibitor for inflammatory disease to Johnson & Johnson). Astellas has been working hard and its valuation is relatively inexpensive at 2.6x enterprise value/sales, about 20x earnings and with a growing balance sheet of about $3.6 billion in cash.

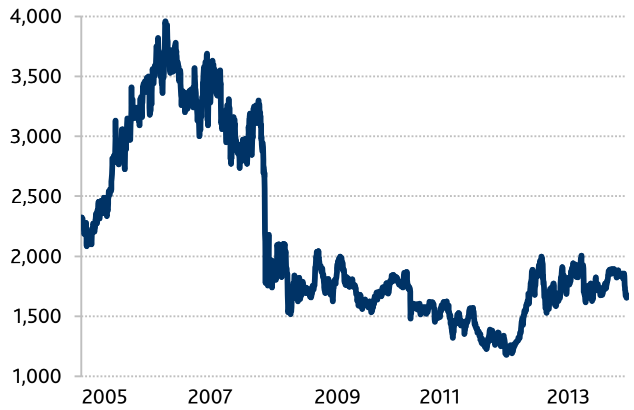
At the other end of the spectrum is Daiichi Sankyo which still has its patent expiration to come and a poor record with acquisitions. Finally this year, Daiichi Sankyo closed the Ranbaxy chapter thanks to Sun Pharma taking over Ranbaxy. Daiichi Sankyo will keep a 9% holding in Sun, worth about $2.6 billion or 23% of its market value. Now the company is without distraction and can fully concentrate on the launch of its oral anticoagulant early next year. The drug should be able to compete given its dosing and efficacy data.

There is no doubt Daiichi Sankyo has not been as deal savvy as Astellas. It added a US biotech with a Roche partnered drug (Plexxikon which developed the BRAF inhibitor Zelboraf for melanoma) in 2011. Zelboraf has been okay for Daiichi Sankyo but Plexxikon's pipeline progress has been slow. Most recently, Daiichi Sankyo announced the purchase of additional oncology assets (Ambit acquisition). The lead drug is the most selective FLT3 inhibitor around. It was once partnered with Astellas so Japanese analysts are dismissive, while haematologists are actually excited about the drug. We know that pharmaceutical companies can get it wrong though. This drug is aimed at Acute myeloid leukaemia exhibiting certain FLT3 mutations (very aggressive blood cancer with no new treatments approved for a decade). The price was reasonable and Ambit complements Plexxikon. Unlike Astellas, Daiichi Sankyo is not an easy story but this is also reflected in the price at less than 1x sales (taking into account the Sun stake). We don't expect this company will grow again (10 year charts below).

## Outlook

The healthcare landscape is in transition. Deals are announced almost every couple of weeks. At times the deal-making surge has become so frenzied, the rush to seize assets has led to shoddy due diligence. Cash is cheap so the temptation is great. This can change quickly and we remain cautious. We also think that the pricing debate will get more intense. Generics keep prices somewhat in check for small molecule therapies, but at present there is no such retardant in biologics. In a couple of years' time, the majority of approved drugs will be biologics and there has to be some mechanism to force some price restraint.

**Daiichi Sankyo Price Chart (Yen, 2005-2014)**




Source: Factset

**Astellas Pharma Price Chart (Yen, 2004-2014)**


Source: Factset

## Notes

1. The investment returns are calculated using the Fund's unit price and represent the combined income and capital return for the specific period. They are net of fees and costs (excluding the buy-sell spread and any investment performance fee payable), are pre-tax, and assume the reinvestment of distributions. The investment returns shown are historical and no warranty can be given for future performance. You should be aware that historical performance is not a reliable indicator of future performance. Due to the volatility of underlying assets of the Funds and other risk factors associated with investing, investment returns can be negative (particularly in the short-term).

   The inception dates for each Fund are as follows:
   Platinum International Fund: 30 April 1995
   Platinum Unhedged Fund: 31 January 2005
   Platinum Asia Fund: 4 March 2003
   Platinum European Fund: 30 June 1998
   Platinum Japan Fund: 30 June 1998
   Platinum International Brands Fund: 18 May 2000
   Platinum International Health Care Fund: 10 November 2003
   Platinum International Technology Fund: 18 May 2000

2. The investment returns depicted in this graph are cumulative on A$20,000 invested in the relevant Fund over five years from 30 September 2009 to 30 September 2014 relative to their Index (in A$) as per below:
   Platinum International Fund - MSCI All Country World Net Index
   Platinum Unhedged Fund - MSCI All Country World Net Index
   Platinum Asia Fund - MSCI All Country Asia ex Japan Net Index
   Platinum European Fund - MSCI All Country Europe Net Index
   Platinum Japan Fund - MSCI Japan Net Index
   Platinum International Brands Fund - MSCI All Country World Net Index
   Platinum International Health Care Fund - MSCI All Country World Health Care Net Index
   Platinum International Technology Fund - MSCI All Country World Information Technology Net Index
   (nb. the gross MSCI Index was used prior to 31 December 1998 as the net MSCI Index did not exist).

   The investment returns are calculated using the Fund's unit price. They are net of fees and costs (excluding the buy-sell spread and any investment performance fee payable), pre-tax and assume the reinvestment of distributions. It should be noted that Platinum does not invest by reference to the weightings of the Index. Underlying assets are chosen through Platinum's individual stock selection process and as a result holdings will vary considerably to the make-up of the Index. The Index is provided as a reference only.

3. Invested position represents the exposure of physical holdings and long stock derivatives.

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