Platinum International Health Care Fund

Bianca Ogden Portfolio Manager

Disposition of Assets

REGION	DEC 2014	SEP 2014
Europe	41%	49%
North America	31%	29%
Japan	5%	5%
Australia	1%	1%
South America	0%	1%
Cash	22%	15%
Shorts	1%	1%

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

Performance and Changes to the Portfolio

(compound pa, to 31 December 2014)

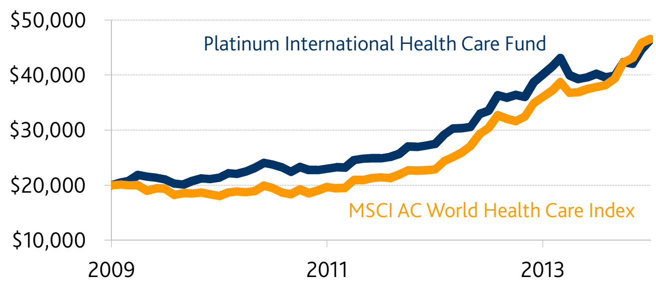
	QUARTER	1YR	3YRS	5YRS	SINCE INCEPTION
Platinum Int'l HC Fund	10%	16%	26%	18%	9%
MSCI AC World HC Index	10%	29%	33%	18%	9%

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

For the 12 months to December, the MSCI AC World Health Care Index rose 29.1% (in AUD), with **Eli Lilly** (34%) leading the traditional "big pharma" stocks, while **GlaxoSmithKline** (-14%) seems to be driven by its finance department (with regular announcements of spin-offs, asset swaps and partial listings) rather than its medical research – but the market is not so easily fooled. Meanwhile, among biotechs, the US market continued to buy the winners, pushing up shares in **Gilead**, **Amgen** and **Regeneron** by (another) 25-50%! Similarly, the strongly positioned Japanese pharmaceuticals performed well (**Astellas** +35% and **Chugai** +27%), while **Takeda** struggled to make substantial changes to its bloated Japanese cost base and was +4% for the year. Elsewhere, the acquisition-driven companies such as **Actavis** (+53%) and **Valeant** (+33%) were championed by investors, and, despite solid contributions from the bulk of our holdings, our comparatively cautious positioning meant the Fund return (+15.6% for the year) was well shy of the Index.

Value of $20,000 Invested Over Five Years

31 December 2009 to 31 December 2014



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

In recent months, a company running clinical trials in the emerging cancer treatment field of so-called CAR T-cell (chimeric antigen receptor – T-cell) therapy caught our attention and the Fund was able to invest in the December IPO of the shares. Thus **Juno Therapeutics** was the major new investment for the Fund in recent months.

Commentary and Outlook

Although we think of the global drug behemoths as *multinational* businesses, the fact is that the pharmaceutical sector is perhaps the quintessential *American* industry. A disproportionate share of global revenues (perhaps 40%) and over half of all profits are generated in the USA. But, more generally, the rewards for risk and innovation, the tension between abusing the trust and yet insisting on the protection of government, the vast legal and corporate finance parasites which (support and) feed on the host, and, of course, the outsized rewards for aggressive sales and marketing, are perhaps the hallmarks of American capitalism – and they are nowhere more evident than in the pharma/biotech industry.

Masquerading as "selfless, caring" companies, the pharma cohort is among the most profitable and hence valuable of all global industries, second only in the USA to the software sector. But as the Ebola outbreak reminds us, huge (but unprofitable) swathes of *real health care* are largely ignored (antibiotics being another perilous key example), while scarcely believable legal manoeuvres are employed to protect profit streams.

2014 draws to a close with the stock market's dazzling favourite, **Gilead Sciences**[1], having a brisk 25% share price correction, as the market digests the Christmas eve news that its US$1,000 per pill (yes, ONE THOUSAND DOLLARS for each pill and patients must take more than 80 of them for each course of treatment!) hepatitis C medication faces a commercial setback. The story is instructive on several levels.

In three clinical trials, Gilead's *Sovaldi* cured 95% of hepatitis C sufferers over two to three months – a clearly effective drug. But Gilead demands US$84,000 for a 12-week (one pill per day) course and has consistently urged critics to consider the grim (and high) costs of not treating the disease rather than proposing a return-on-investment basis for its pricing. Indeed, the biotech sector had a rare wobble earlier in 2014 (-20%), not least because of pointed questions in the US Senate concerning expenditure on *Sovaldi*.

Then, just before Christmas, the largest PBM (Pharmacy Benefit Manager, i.e. agent of the health insurers who helps manage pharmaceutical expenses), Express Scripts, announced a deal with AbbVie (once the pharma division of Abbott Laboratories) whereby a discount had been agreed to replace *Sovaldi* on the Express Scripts formulary with AbbVie's *Viekira Pak*. The behaviour of a dominant gatekeeper like Express Scripts worried the stock market and it hurriedly reduced exposure to Gilead.

Pharmaceutical industry lobbyists insist that this episode shows the market doing its job, i.e. competing and thus driving down prices. But health insurers complain that while US$70,000 per hepatitis C patient is preferable to US$84,000, it is still too much for the system to afford as more Americans move onto long-term ("chronic") drug treatments.

Meanwhile, earlier in December, a key trial finished in Boston where the US Supreme Court's 2013 ruling over the so-called "pay-to-delay" deals was tested for the first time. In the end, the jury agreed with the plaintiffs that **AstraZeneca's** rumoured US$1 billion payment to Indian generics supplier, Ranbaxy Laboratories, for not launching a Nexium (heartburn) generic in 2008 was unreasonable. But the jury continued, on a seeming technicality, that this (somehow!) did not distort the market – apparently not least because Ranbaxy's manufacturing shortcomings[2] meant the whole question had become hypothetical, for the moment. Fascinatingly, two alleged co-conspirators in this plot *settled* with the plaintiffs ahead of the jury decision, which is in any case being appealed, *and* a similar court case will get underway shortly in Pennsylvania.

The key point is that while the industry reminds us of the creativity and skill of its legal counsellors, both the government (i.e. the legislators, the White House, the Federal Trade Commission, etc) and the health insurance providers seek legal and market mechanisms to restrain the drug companies. For the moment, as the share prices make clear, "big pharma", with the best lawyers and lobbyists money can buy, has the upper hand.

Another reflection of this prosperous situation can be seen in the behaviour of the bankers. To be clear, 2014 has been the biggest year on record for drug industry mergers and acquisitions (M&A), even without a successful conclusion to **Pfizer's** attempted takeover of **AstraZeneca**. In fact, this

1 Gilead was an important holding of the Fund, back before it became such a well-told story.

2 At the time of the verdict, the US Food and Drug Administration (FDA) had withdrawn approval for the Indian factory to supply the drug.

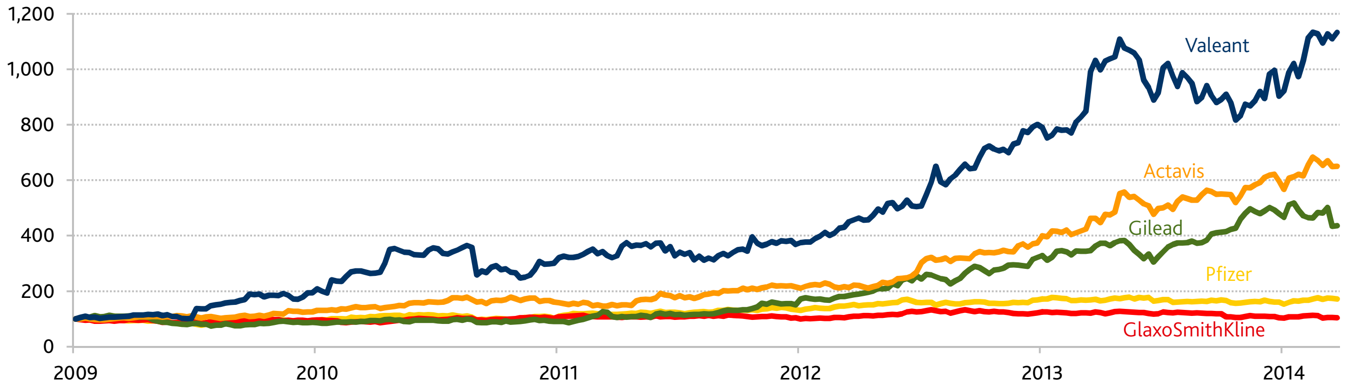
report would be very long indeed if it sought to analyse (let alone justify!) the major deals of even the last few months. The proof is in the fact that multi-billion dollar deals were only one-day news stories by the time **Otsuka** of Japan bewildered onlookers by paying US$3.5 billion for a glorified cough mixture medication and **Merck** surprised everyone by paying US$8.5 billion for an antibiotics business – just a day before the purchased company lost a key patent on its top-selling drug!

But the bigger lesson from this corporate finance splurge is that the industry is changing, both in its pecking order and in how the major players seek to do business. While it seems that Switzerland's **Roche**, with its strengths in oncology and predominance in hard-to-copy biologics (rather than generic-prone small molecules), will be hard to beat, and by contrast, **GlaxoSmithKline** seems to flail around with short-term accounting department tricks, elsewhere some big moves are being made. The aforementioned **Gilead**, at US$142 billion even after the setback, has joined the ranks of large market capitalisation companies from an almost standing start just a few years ago. Among 2014's best performing stocks, **Actavis** (market cap now US$68 billion) joined **Valeant** (US$55 billion) as very large, seemingly successful proponents of an acquisition-led strategy of "low/no R&D" and cost-cutting. While this is perhaps the logical financial and legal end-game for the industry in the USA, it is completely at odds with the implied social pact of patent-protected profits in return for risky, innovative medical research. To the extent that these two aggressive organisations continue on this path (and are copied by others), surely political reaction will intensify.

Sanofi, one of the Fund's key holdings, was in the news for the wrong reasons when its Paris-based board fired its Boston-based, German-Canadian CEO, who was held in high esteem by the stock market – justly, given the effective job he did in recent years to reorganise and energise the company. Investors worried that the board sought to dilute the company's capitalist tendencies by focusing on its importance to the national science base. So it was interesting to see the recent announcement that Sanofi will effectively outsource several hundred French R&D staff with the sale of its Toulouse research facility to the German "drug discovery specialist" Evotec. In the short-term, the market takes comfort that the board of Sanofi continues to improve the efficiency and productivity of the organisation. It seems the real reason for the CEO's removal was this year's disappointing performance by the company's US diabetes franchise. This is clearly a more palatable reason for managerial change than the nationalistic interference first feared.

More generally, outsourcing is another element in the changing focus of "big pharma" – just as "big oil" tends to leave the technically challenging aspects of oil discovery and well optimisation to specialist third parties, so, perhaps, "big pharma" drifts away from drug discovery in preference for globalising its commercialisation efforts, managing patent portfolios and trying to be predator, not prey, in the M&A arena.

Stock Price Movements (local currency)



Source: Factset

The portfolio manager of the Fund, Bianca Ogden, is currently on maternity leave.
Kerr Neilson is the portfolio manager in Bianca's absence.

Notes

1. The investment returns are calculated using the relevant 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: 28 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

   (NB: The gross MSCI Index was used prior to 31 December 1998 as the net MSCI Index did not exist.)

2. The investment returns depicted in this graph are cumulative on A$20,000 invested in the relevant Fund over five years from 31 December 2009 to 31 December 2014 relative to its benchmark Index (in A$) 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

   The investment returns are calculated using the relevant 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 benchmark 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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