

SECTOR SPOTLIGHT

Healthcare Convertible Bonds – Dynamic Franchises / Compelling Structures

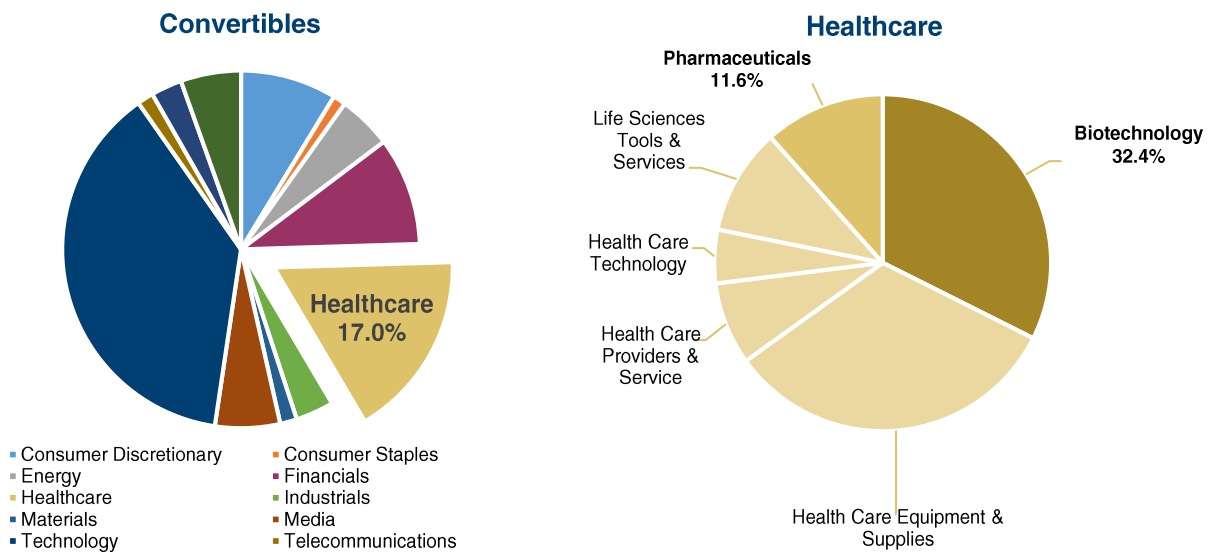
By Florian Eitner, CFA, Portfolio Manager

The Healthcare sector has traditionally been well represented in the convertible bond universe, usually ranking only behind Technology in size. Healthcare companies opt to issue convertible bonds for varying reasons, including balance sheet considerations, acquisitions, debt refinancing, or share repurchases. Biotechnology & specialty pharma companies, in particular, have historically utilized the convertible bond asset class considerably to finance their growth objectives.

For example, before Celgene Corp became an oncology pioneer and eventually an industry powerhouse, it financed its research and commercialization endeavors in multiple myeloma and myelodysplastic syndromes (MDS) through the issuance of convertible bond securities. In late 2019, as its lead drug Revlimid had grown into a \$10bn+ revenue run-rate, Celgene was eventually acquired for over \$89bn by pharma/biotech behemoth Bristol-Myers Squibb.

Other examples of innovative Healthcare companies that ‘grew up’ in the convertible bond asset class include biopharma developer Onyx Pharmaceuticals (since acquired by biotechnology large cap Amgen Inc), Botox & eye care manufacturer Allergan Ltd (now part of AbbVie Inc) and leading cystic fibrosis franchise purveyor Vertex Pharmaceuticals Inc. These innovators used the convertible market in a meaningful way to capitalize on the growth potential of their R&D projects, resulting in a less volatile opportunity for investors to participate in their developing growth narrative.

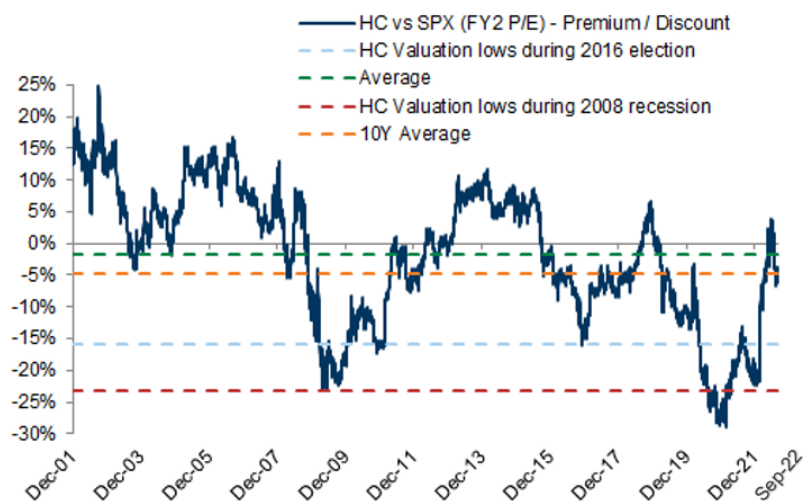
Today, biotechnology & specialty pharma continue to represent a large portion of the Healthcare segment of the convertible bond universe¹:



¹Convertibles: ICE BofA All US Convertible Index. Source: ICE BofA Research: Data represents convertible universe as of 9/2/2022.

While currently elevated discount rates represent slight headwinds to the valuations of all publicly traded growth companies, the underlying equities of outstanding Healthcare convertible bond issuers in particular have recovered meaningfully since the March 2020 market bottom, yet still continue to exhibit attractive valuations vs. S&P 500 as shown in the chart below:

The Healthcare Sector Continues to Exhibit Attractive Valuations vs. S&P 500²



Historically, M&A has been an enduring theme in Healthcare convertible bond investing, and the convertible bond universe tends to include the kind of target profiles that acquirers are seeking. These acquisition targets tend to be fast-growing, usually earlier-stage, but most importantly, eventually free cash flow-accretive. Investing in a Convertible Bond represents an ideal investment to participate in the upside of biotechnology and specialty pharmaceuticals. They provide the upside of potential M&A and an overall growth trajectory of the sector, while providing superior downside protection in relation to their underlying equities.

Currently, our Convertible Bond Strategy's holdings³ have exposure to potential acquirers including life science/diagnostics mega-cap Danaher Corp & medical device developer Boston Scientific Corp. Also, we hold a number of emerging, high-growth biotech, specialty pharma & device innovators (e.g. Neurocrine Biosciences Inc, Jazz Pharmaceuticals plc, and Halozyne Therapeutics Inc.) that are potential acquisition targets. Although incrementally rising acquisition debt pricing presents a marginal headwind, we expect M&A and resurging organic growth to remain a continuing theme in Healthcare convertible bond investing.

²Source: Bloomberg, SSI internal research: Data as of 9/2/2022. HC represents the equity Healthcare sector, SPX represents the S&P 500. FY2 P/E represents Fiscal Year ending 2023 Price/Earnings.

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