COMMENTARY

September 14, 2010

Dear clients and colleagues,

Many of our top holdings in the portfolio are companies that have secular growth drivers and are less cyclical. You may recall previous commentaries where we outlined some of favorite investment themes. One of these themes is the healthcare sector.

We like healthcare because it is a very large global market that is growing faster than GDP due to demographics, new and better treatments and technologies, and emerging economies putting in place a social safety net for their population.

The pharmaceutical industry is facing unprecedented challenges. Between 2011 and 2013, US$74 billion of revenue will be lost through patent expirations. R&D at the largest pharmas has grown four-fold between 1995 and 2008, yet the number of new drugs approved in 2008 was at a 15-year low.

Collectively, the top 20 pharma companies have $175 billion in cash and they are using their cash reserves to acquire smaller, faster-growing competitors with late-stage products.

Here are a few statistics to give you a perspective on the opportunity some markets represent.

The antibiotic market is US$42 billion, the cholesterol market is US$35 billion, and the diabetes market is US$30 billion. Cancer is bigger than all of them.

In the ocular market, 40% of the people will develop cataracts, 5% glaucoma, and 10% will have age-related macular degeneration. That is 2/3rd of the population. The rest will have glasses.

Thirteen percent of our portfolio is invested in the healthcare sector in nine different companies. Our strategy is to find good companies that are leaders in their field. We minimize risk by building a diversified portfolio by activity/disease/country and look for minimal clinical risk.

The nine companies are:

Pharmaceutical Product Development Inc. (PPDI US), www.ppdi.com: The company is the second largest publicly traded Contract Research Organization (CRO) in the world with sales of $US1.5B. It offers drug discovery and development services to pharmaceutical, biotech and medical device companies. It should benefit from rising R&D as well as increased outsourcing by large pharma and biotech.

Nakanishi (7716 JP), www.nsk-nakanishi.co.jp/: With sales of US$230 million, the company is the second largest global supplier of gyration equipment for the dental industry. The company is gaining market share in a market growing at more than 10% thanks to emerging markets such as China and India.

Eurofins Scientific (ERF FP), www.eurofins.com: With sales of US$900 million, the company is one of the largest global providers of safety and purity analysis for the food, pharmaceutical and cosmetics industries.

Martek Bioscience (MATK US), www.martekbio.com: With sales of US$350 million, the company is the world leader for the production of Omega3, DHA, ARA oil derived from microalgae, a non-animal, sustainable source. The company's products are present in most infant formula and increasingly in food as an ingredient.

Hogy Medical (3593 JP), www.hogy.co.jp/: With sales of US$350 million, entirely in Japan, the company manufactures and sells medical supplies, sterilized tools, disposable injectors, and masks and gowns used by surgeons in operations room. The company prepares kits and offers software to hospitals, which find tremendous value outsourcing this function to Hogy.

Carl Zeiss Meditec (AFX GR), www.meditec.zeiss.com: With sales of US$900 million, the company is the world leader in the field of medical technology for ophthalmology. The company is also an emerging player in intraocular lenses as well as brain cancer therapy.

Bachem (BANB SW), www.bachem.ch: With sales of US$175 million, the company is a world-class manufacturer of ingredients for pharmaceutical products. The company's growth will come from new products as well as the upcoming approval of a number of new peptide-based drugs for the treatment of diabetes.

Furiex Pharmaceutical (FURX US), www.furiex.com: Furiex Pharmaceuticals is a spin-off of PPDI. The company is a drug development company that partners with pharma and biotech companies. The company will receive royalties from two approved products and has three partnered products in Phase II clinical trials.

Isoft Group (ISF AU), www.isofthealth.com: With sales of $500 million, the company is one of the leading global providers of IT systems to hospital. Growth should come from the upgrading of many outdated systems, the need to better control rising healthcare costs, and Electronic Patient Record initiatives.

We feel this group of companies has excellent prospects and should do well in any economic environment. The healthcare sector has not outperformed the overall market in 2009 and so far in 2010. Yet, it is the best performing sector in China in the last 12 months. In terms of multiples, the sector is now at par or at a slight discount to the overall market. Given strong growth characteristics, low valuation, low cyclicality and increased M&A activity, we remain overweight.

Have a good week.
The Global Alpha Team