

Sector Corner

Healthcare: Nothing to Frown At

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The Health Care sector has seen renewed interest during the second quarter of 2011 in light of fears over a slowdown in global growth and ongoing concerns over European sovereign debt. Health Care outperformed the S&P 500 by 768bps in the quarter and has had the best performance of all the sectors. While health care companies' valuations are influenced by the overall market environment and resulting equity multiples, their actual financial results or outlook generally are not; they depend on market-independent events such as pipeline developments, reimbursement decisions and patent positioning.

The Health Care sector continues to exhibit many attractive investment opportunities. Health Care is particularly appealing due to its isolation from many geopolitical risks and tends to outperform when investors are seeking more defensive strategies. On the other hand, most sub-sectors of Health Care should continue to do well if markets continue their bullish ascend through this year.

Many investors often dismiss Health Care as defensive and expect underperformance in a strong market year. In 2010, Health Care was the worst-performing sector, only gaining 0.71% versus a 12.78% gain for the S&P for the year. However, what is often overlooked is that large cap pharma (-1.08% in 2010) represents a large portion of the sector and single-handedly caused the sector's underperformance. Other sub-sectors tend to outperform in such an environment, as was observed in biotechnology (+37.73%), hospitals (+21.57%) and HMOs (+14.87%) in 2010. Keeping this disproportionate sub sector performance in mind, we continue to seek opportunities outside of the large cap pharma space and believe that Health Care will continue to yield attractive investment opportunities.

Allergan is a company with a continued attractive growth outlook. While Allergan has a large presence in eye care and is a leading innovator in obesity treatments and breast aesthetics, Botox, its most visible product, is often the main focus of investors. In its cosmetic indication, Botox is sold for treatment of moderate to severe frown lines between the brows. In this indication, it has a solid safety record and is finding increasingly broader acceptance, driven by demographics as well as a sentiment shift away from cosmetic surgeries toward non-invasive

treatments. Botox, however, is not limited to cosmetic applications. The drug is approved for a number of therapeutic indications, including upper limb spasticity, severe sweating and, most recently, migraine. Test results in migraine treatment have been impressive and investor interest is focused on the launch ramp numbers in this indication. Later this year, Allergan is seeking FDA approval for Botox in overactive bladder disease (OAB), which has the potential to represent additional growth for the product as well as the company. Allergan is testing Botox in other numerous other indications and historically has achieved a pipeline approval rate of two to three times the industry average. This past success poses a slight challenge to Allergan, as the company has more than doubled sales over the past five years and future growth rates will have to be achieved off the current revenue base of approximately five billion dollars. With Botox Cosmetic on track with increasing demand from the resurging consumer, the drug achieving consecutive approval successes in therapeutic indications, the possibility for Botox in migraine to be a larger opportunity than anticipated and potential upside from an approval in OAB, we believe mid-teen bottom line growth expectations are reasonable.

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