



Tekla's Omstead: Great Promise From 'A New Generation' Of Health Care Firms

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed Dan Omstead, chief executive officer at Tekla Capital Management—which sponsors four health-care oriented closed-end funds. Read the Q & A below as Dan says that the pandemic proved the promise of health care and biotech companies as it helped vaccine maker Moderna grow from a small form



Dan Omstead

to one of the largest health-care companies in the world, and now he is looking at 'a new generation of companies that are well funded and developing very innovative products against every health-care target you can imagine.'

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CHUCK JAFFE: We're talking health care and health care investing with Dan Omstead, chief executive officer at Tekla Capital Management, this is The NAVigator. Welcome to The NAVigator, where we talk about all-weather active investing and plotting a course to financial success with the help of closed-end funds. The NAVigator is brought to you by the Active Investment Company Alliance, a unique industry organization that represents all facets of the closed-end fund industry, from users and investors to fund sponsors and creators. If you're looking for excellence beyond indexing, The NAVigator's going to point you in the right direction. And today it's pointing me in the direction of Dan Omstead, chief

executive officer at Tekla Capital Management, which is a fund sponsor. In fact, they run four closed-end funds; Tekla Healthcare Investors, Tekla Life Sciences Investors, Tekla Healthcare Opportunities Fund, and Tekla World Healthcare Fund. You can learn more about the firm and its funds at TeklaCap.com. Dan Omstead, thanks for joining me on The NAVigator.

DAN OMSTEAD: Thanks for having me, Chuck.

CHUCK JAFFE: Let's start with just a quick overview of health care and why four funds. Because on the one hand people say, "Well yes, I need to get health care," but how much do they need to differentiate and why? And what are the benefits of maybe being more granular? So explain a little bit about the funds and why the need for so many in what broadly is one space.

DAN OMSTEAD: So I would say health care is a growing and dynamic sector. It's focused on innovation and improving the lives of patients. That's the big picture. But there's many, many subsectors within health care. We count about 11 or 12 subsectors ranging from HMOs and insurance companies all the way to biotech and everything in between. And so each of these four funds seeks both from strategy and from allocation selection to address a slightly different demand and investor type. So we have two, HQH and HQL are pure equity funds, and they invest mostly for long-term capital gains in a variety of sectors but focused on biotechnology and pharmaceuticals. These contrast with our other two funds, Tekla Healthcare Investors and Tekla Healthcare World, and those funds are not pure equities but rather growth and income focused. Where they have not only the equities of companies but also the debt, and REITs, and use some other income sources to get that result. And net-net, they are more focused, these latter two, on large cap, pharmaceutical companies, and distributors, and HMO, rather than biotechnology. And in particular, one of them is more domestic focused and the other has a high allocation to ex-US companies. So we kind of figure out how to address health care and the innovation associated with it in four different ways for hopefully four different kinds of demands from individual investors.

CHUCK JAFFE: And I should point out for folks who maybe aren't quite the mutual fund and ticker junky that I am, HQH Tekla Healthcare Investors and HQL, if people are wondering about those tickers, Tekla was the investment arm of Hambrecht & Quist. So these funds started under the HQ for Hambrecht & Quist, which was well known for running specialized

funds. And then Hambrecht & Quist was acquired by J.P. Morgan, and then ultimately Tekla was spun out of J.P. Morgan, so that gives a little background. We are living in super interesting times when it comes to health care and biotech investing right now. Everybody's talking about what the pandemic did just in terms of like, hey, you had to have vaccine companies. But it kind of changed the whole medicinal picture and the health care picture, didn't it? How much of that story is playing out and what directions do you think the interesting parts of health-care are? Because not everybody is thinking that the interesting part of the future is about vaccines.

DAN OMSTEAD: Two parts to answering that question. The first is how has the pandemic changed health care? I can say this. It's very interesting that a year and a half ago, the distribution, biggest companies in health care were the biggest pharmaceutical companies. But a year and a half later one of the vaccine companies, one started locally in the Boston area five or 10 years ago, has been successful in developing and commercializing a vaccine such that it is now one of the top three biggest biotech companies in the world. So that's quite a change to go from relatively small to among the biggest in just a year. In terms of what's going on in health care, it's really just an amazing place to be. There's a tremendous amount of money raised against a lot of companies that the last two or three years have broken records for the number of IPOs. And so you now have a new generation of companies that are wealth-funded and developing very innovative products basically against every health care target that you can imagine, from cancer, to CNS, to diabetes and so forth. I think the most interesting things these days range from new technologies, particularly in cancer, for example, targeted oncology where you look for products that are very focused on the cancer cells that are in your body and less toxic on the rest of your body. This approach has been kind of incubating for five or 10 years, really coming to the fore now. Another approach is the treatment for rare diseases. Rare diseases that affect a few number of people but have a very big income, particularly on young kids, lots of treatments there. Cellular therapies, both for oncology and for other kinds of indications are developing, and there's also a lot of central nervous system treatments being put to the fore lately. I just saw the first drug for the treatment of Alzheimer's approved here in the last couple of weeks, first such drug in many, many years. So lots of good things happening across a lot of therapeutic areas and a lot of

clinical indications, and with a lot of investment dollars put towards supporting those developments.

CHUCK JAFFE: You also have some overarching concerns. I mean, broadly health care is still a hot potato politically speaking, and we know that Washington can't agree on much of anything. I realize that we're not exactly looking at whether or not they will repeal the Affordable Care Act, but how much do you factor at all the legislative and the regulatory picture into things? And how good or bad does that look right now as a health care investor?

DAN OMSTEAD: Well, you can look at it from two points of view. The one that's mostly in the news is drugs are too expensive. As an investor I can tell you, we look at the costs and the benefit of many of the drugs and treatments that are being developed, and we see them as fairly priced. What is the value of saving the life of a six-year-old kid? I think it's pretty considerable. And the total cost of the health-care system can be pretty limited when you consider just the benefit and the small number of kids for rare diseases for example. So I think drug prices can look pretty expensive, but when you compare a therapy to keep a kid out of the hospital or being able to have them live for another six or 12 months, the value of that is pretty considerable, and the cost is actually pretty reasonable in that regard. I think the balancing factor is we have to come to a point where you can charge as a company a reasonable amount of money to support the development of these very expensive to develop drugs. I'm pretty sure we're going to get there, it's in everybody's best interest to have innovation lead to new drugs, lead to saving lives and reducing morbidity. And on the other hand, not costing so much that it bankrupts the Medicare system or the country in general. I'm pretty optimistic that we'll get there. There'll be some ups and downs, and pushes and pulls, but in the end I think it'll all work out for everyone's benefit.

CHUCK JAFFE: Your background prior to coming to money management and becoming portfolio manager at Tekla, your background was in biotech, you were a scientist. I'm curious, people can love the biotech space, the health care space, the areas that we're talking about, but does your experience make you perhaps more skeptical? Because every company, every nascent pharmaceutical company, biotech company starts with an idea, "This is what we can do. How we can help people," and it's always good intentions. But to actually get to where it's profitable, a business that you want to own, is a very different thing. Does your background make you more skeptical about the prospects for companies, or does it make

you more optimistic that, well, there's a solution for everything and I want to be investing to find who figures it out?

DAN OMSTEAD: Well, I think good investing in the health care space requires a balance of those two things. One the one hand, my background is academics, I worked at Merck and J&J, and was CEO of a biotech company so I think I understand the development side. And I've been doing the investing side, investing in the companies I used to work in and helped to develop drugs in, I've been doing this investing thing for 20 years. So I think I have a good balance, and I think you need to look at both sides. Innovation for the sake of innovation doesn't really accomplish much, but innovation for the sake of a specific clinical or regulatory outcome is valuable and can be worth investing in. And so I think the experience of having good science, having been a research scientist, an executive in a biotech company, and then doing this investing [inaudible] a perspective in how to pick the things that are a little bit more likely to work than the ones that maybe aren't. So it's kind of looking at it from all perspectives, coming up with a list of companies that you think can do well and then investing in those.

CHUCK JAFFE: Dan, this has been really interesting. Thanks for joining me on The NAVigator to talk about it.

DAN OMSTEAD: My pleasure, anytime. Happy to chat, thanks.

CHUCK JAFFE: You've been listening to The NAVigator, which is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. I'm Chuck Jaffe and you can check out my show on your favorite podcast app or at MoneyLifeShow.com. You can get much more information on investing in interval funds, closed-end funds, and business-development companies at AICAlliance.org, the website for the Active Investment Company Alliance. They're on Facebook and LinkedIn @AICAlliance. Thanks to my guest, Dan Omstead, the chief executive officer at Tekla Capital Management, which sponsors Tekla Healthcare Investors, Tekla Life Sciences Investors, Tekla Healthcare Opportunities, and Tekla World Healthcare. Learn more about the firm and its funds at TeklaCap.com. The NAVigator podcast is new every Friday, follow along on your favorite podcast app and come back next week to learn more about investing with closed-end funds. Until that next time, happy investing everybody.

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