TEKLA HEALTHCARE INVESTORS
Form N-CSR
December 02, 2015

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF REGISTERED MANAGEMENT INVESTMENT COMPANIES

Investment Company Act file number 811-04889

Tekla Healthcare Investors
(Exact name of registrant as specified in charter)

100 Federal Street, 19th Floor, Boston, MA — 02110
(Address of principal executive offices) — (Zip code)

100 Federal Street, 19th Floor, Boston, MA 02110
(Name and address of agent for service)

Registrant s telephone number, including area code: 617-772-8500

Date of fiscal year end: September 30

Date of reporting period: October 1, 2014 to September 30, 2015

ITEM 1. REPORTS TO STOCKHOLDERS.

TEKLA HEALTHCARE INVESTORS
(FORMERLY H&Q HEALTHCARE INVESTORS)

Annual Report

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TEKLA HEALTHCARE INVESTORS

DISTRIBUTION POLICY

The Fund has implemented a managed distribution policy (the Policy) that provides for quarterly distributions at a rate set by the Board of Trustees. Under the current Policy, the Fund intends to make quarterly distributions at a rate of 2% of the Fund's net assets to shareholders of record. The Fund intends to use net realized capital gains when making quarterly distributions, if available, but the Policy would result in a return of capital to shareholders, if the amount of the distribution exceeds the Fund's net investment income and realized capital gains. With each distribution, the Fund will issue a notice to shareholders and a press release that will provide detailed information regarding the amount and estimated composition of the distribution. You should not draw any conclusions about the Fund's investment performance from the amount of distributions pursuant to the Policy or from the terms of the Policy. The Policy has been established by the Trustees and may be changed or terminated by them without shareholder approval. The Trustees regularly review the Policy and the frequency and rate of distributions considering the purpose and effect of the Policy, the financial market environment, and the Fund's income, capital gains and capital available to pay distributions. The suspension or termination of the Policy could have the effect of creating a trading discount or widening an existing trading discount. At this time there are no reasonably foreseeable circumstances that might cause the Trustees to terminate the Policy.

To our Shareholders:

On September 30, 2015, the net asset value (NAV) per share of the Fund was $29.61. During the twelve month period ended September 30, 2015, total return at NAV of the Fund was 8.76%, with distributions reinvested. The total investment return at market with distributions reinvested was 4.94% during the same period. Thus, the Fund NAV and market return fell short of the NASDAQ Biotech Index (NBI) return for the twelve month period. However, the Fund NAV and the market returns outperformed the S&P 500 Index for the same twelve month period. In addition, the Fund's NAV returns exceeded the NASDAQ Biotech Index during the six month period ending September 30, 2015 but the market return fell short. The S&P 500 Index returns during the six months period were higher than the Fund's NAV and market returns. Comparisons to the relevant indices are listed below.

Investment Returns	**Six Months Ended 9/30/15**	**Twelve Months Ended 9/30/15**
At Market	-17.51%	4.94%
At Net Asset Value	-9.03%	8.76%
NASDAQ Biotech Index	-11.75%	11.14%
S&P 500 Index	-6.18%	-0.62%

Investment Highlights

The NBI has generally demonstrated more volatility in the twelve month period ended September 30, 2015 (the report period) than it had in recent years. While the NBI was among the best performing sectors for the approximately seven years, rising more than fourfold (+346%) between the end of 2008 to the end of this report period, the broader S&P 500 Index rose approximately 145% in the same period. So, considering the last seven years as a whole, as the NBI significantly outperformed the broad market, we are satisfied with the overall performance of the healthcare sector and the Fund. See the following chart for a comparison.

However, starting on July 20, 2015 when the NBI reached an all-time high, through September, the NBI decreased approximately 24% while the S&P 500 Index decreased approximately 9%.

It is our impression that the recent healthcare/biotech pullback was the result of multiple factors. Even given the strong relative and absolute growth rates we see in the sector, there appeared to be a broadly felt notion that valuations were getting stretched, particularly for a few highflying outlier companies. In recent quarters we have seen analysts suggesting valuation as the basis for concerns about a potential reversal, healthy or otherwise.

We think valuation, especially for a few highly publicized companies, may have played a part in the recent NBI reversal but was likely not the only key factor in the drop. In the last few months, in our view, several questions, ultimately linked to drug pricing, have had an impact on healthcare sector sentiment. First, in mid-summer, a small specialty pharmaceutical company was noted to have acquired an old, niche product from another company and quickly increased the price of this product more than 50 fold. This action produced considerable negative publicity. Since this disclosure, the topic has become politicized. At least one presidential candidate has elected to emphasize drug pricing in her campaign, weakening sentiment toward the sector and, at least in our view, ultimately exacerbating the pullback described above.

In addition, as the report period was closing (and beyond), another specialty pharmaceutical company was alleged to have, at the least, used questionable practices in the pricing and marketing of a number of its products. This situation is still being investigated. In aggregate, it is fair to say that a concern about pricing power in the healthcare sector has heightened volatility and downward pressure, particularly in the specialty pharmaceutical subsector and even more particularly in situations where pricing may not reflect value to patients.

We believe that current concerns about pricing power in the healthcare and biotech industries are overblown. It is our observation that the vast majority of companies, particularly many of the innovative companies we prefer, price their new and novel products based on the value they bring to patients. There are certainly companies that try to price products in order to seek what one presidential candidate calls "excess" profits (whatever that means), but we believe most companies try to price their products fairly. Beyond this, we note that there are legislative controls in place in the US to limit executive branch over-reactions. At the moment, the government is limited in its ability to "control" drug pricing. Given the current and expected government makeup, we don't see this situation changing soon. Bottom line, we think the industry's ability to price drugs that reflect their value to patients will remain a positive for the sector for some time.

More generally there are always factors that make us more bearish and others that make us more bullish. At the moment, our biggest concern is how the IPO and follow on market has been behaving. This market has been growing explosively for the last 2-3 years though it may well now be cooling at least for the moment. In the last couple of years there have been more than 225 priced IPOs raising more than $25 billion in our sector. Moreover, in the same timeframe, there have been more than 850 priced follow-ons (including primary, secondary, and reg-direct offerings) follow-on financings raising greater than $100 billion. There have been three main consequences. First and foremost, an entirely new generation of novel public companies has been created which is now fully funded. It is our belief that this funding phenomenon has armed a generation of companies that will both improve the quality of life for millions of people and also be the basis for another wave of sales and earnings growth in our sector. This should ultimately extend and expand the positive sentiment that our sector has earned and received.

Second, and less appreciated, successful listing of these companies has re-energized venture funding in the healthcare sector. Prior to the last couple of years, it is our impression that limited partnership (LP) funding interest in healthcare had waned. As a consequence we observed less venture capital funding available and fewer well-funded venture backed companies than there might otherwise have been. We expect that the successful recent investment exits of at least a few venture funds will catalyze additional LP interest in the biotech space. In time, this should facilitate the next round of IPO investment by public investors.

Third, we note quite a bit of clinical and other data that is being generated by the new IPO companies. In general these companies have been managed by more experienced individuals and have often gone public at a later stage than previous IPO generations. While there have been some "story" stocks (i.e., great ideas without much clinical validation), a significant portion of recent IPOs have been relatively later stage than we recall in the 1999-2000 timeframe. Some current IPO companies have already initiated clinical trials that could lead to relatively near term regulatory approvals. We expect that such companies will create value more quickly than the famed 1999-2000 generation of IPOs. We anticipate that this will materially reduce the time from concept to profit that hampered value creation after the last great wave of IPOs.

In addition to these impressions, after the recent pullback, many healthcare and biotech companies are now at lower valuations. We note that after the September 2015 pullback described above, valuations have dropped markedly. Mark Schoenebaum of Evercore ISI , a well-known sell side analyst, has noted that the price/earnings ratio of the four biggest biotech companies (Gilead Sciences Inc., Amgen Inc., Celgene Corporation and Biogen Inc. which he and others use as a proxy for the sector) was lower on an equal weighted basis than the S&P 500 Index. Mr. Schoenebaum asserts that the P/E for this group has only been below that of the broader index three other times in the last 10 years.

Furthermore, Bloomberg calculates that the consensus long term growth rate of these four companies is 14.73% compared to a consensus of 10.1% for the S&P 500 Index. Given these numbers, growth adjusted earnings (i.e., P/E divided by growth rate or PEG) for the 4 largest biotech companies is at an attractive level relative to its own history and to that of the S&P 500 Index. It is our experience that PEG ratios are among the best indicators of value.

There can be no certainty about the future and there can be plenty of things that go awry, but to us this picture suggests that the healthcare sector in general and the biotech sector in particular still provides an interesting investment opportunity.

Portfolio Highlights

During the report period HQH held positions in more than seventy companies. Healthcare related products and services were the principal business of essentially all of the investments, as determined by Tekla. In the report period, investments in Heron Therapeutics, Inc., Allergan plc, Incyte Corporation, Celladon Corporation and Aetna, Inc. were among those Fund positions which most benefitted performance relative to the

NBI Index. Positions in Mylan NV and Ilumina, Inc. detracted from relative performance. In addition, not owning Pharmacyclics, Inc., Syngeva BioPharma Corp and Anacor Pharmaceuticals, Inc. also detracted from performance.

We note that HQH continues to use the NBI as its narrow benchmark and the S&P 500 Index as its broad benchmark. We are required to adopt such benchmarks. However, HQH is quite unique with its near singular focus on healthcare but broader (than the NBI) focus on many healthcare subsectors and its intent to invest a substantive portion of its assets in pre-public venture companies. And while HQH does seek to invest a significant portion of its public portfolio assets (often in the general range of 50% in biotech related entities), for volatility and other reasons, it does not seek to invest the vast majority of its assets in biotechnology. By contrast standard GICS analysis determines that more than 80% of NBI components are considered biotech related. Our own analysis suggests that substantively more than 80% of the NBI would or should be considered biotech related. At times the substantive difference between the portfolio goals of HQH and the composition of the NBI complicate the analysis of Fund performance while at other times it does not. Similarly, with respect to the broad S&P 500 Index, relative performance of the healthcare sector may also complicate analysis of Fund performance. In the interest of clarity at some notable moments, we may elect to provide you with color that may be helpful in your analysis.

Investment Changes

During the twelve month period ended September 30, 2015, within the public portfolio, the Fund established positions in several companies including ACADIA Pharmaceuticals Inc., Agilent Technologies, Inc., Allscripts Healthcare Solutions, Inc., Alnylam Pharmaceuticals, Inc., Auris Medical Holdings AG, Eli Lilly & Co, Paratek Pharmaceuticals, Inc., The Medicines Company, Ultragenyx Pharmaceutical Inc. and United Therapeutics Corporation. During the same twelve month period, the Fund exited positions in Actavis plc, Catamaran Corporation, Cubist Pharmaceuticals, Inc., Infinity Pharmaceuticals, Inc., Ironwood Pharmaceuticals, Inc., Jazz Pharmaceuticals plc, Molina Healthcare, Inc., Perrigo Company plc, Sangamo BioSciences, Inc. and Shire plc.

During the same twelve month period, within the venture portfolio, the Fund made initial investments in Afferent Pharmaceuticals, Inc., Merus B.V., Ovid Therapeutics, Inc. and follow-on investments in IlluminOss Medical, Inc. and Insightra Medical, Inc. During the report period CytomX Therapeutics, Inc. completed an IPO.

As always, if you have questions, please feel free to call us at (617) 772-8500.

Daniel R. Omstead, PhD
President

TEKLA HEALTHCARE INVESTORS

LARGEST HOLDINGS BY ISSUER

(Excludes Short-Term Investments)

As of September 30, 2015

Issuer - *Sector*	**% of Net Assets**
Gilead Sciences, Inc. *Biotechnologies/Biopharmaceuticals*	8.9%
Celgene Corporation *Biotechnologies/Biopharmaceuticals*	8.3%
Incyte Corporation *Drug Discovery Technologies*	5.1%
Biogen Inc. *Biotechnologies/Biopharmaceuticals*	5.0%
Alexion Pharmaceuticals, Inc. *Biotechnologies/Biopharmaceuticals*	4.9%
Regeneron Pharmaceuticals, Inc. *Biotechnologies/Biopharmaceuticals*	4.6%
Vertex Pharmaceuticals Incorporated *Biotechnologies/Biopharmaceuticals*	4.5%
Allergan plc *Generic Pharmaceuticals*	4.2%
BioMarin Pharmaceutical, Inc. *Biotechnologies/Biopharmaceuticals*	3.9%
Mylan NV *Generic Pharmaceuticals*	3.3%

SECTOR DIVERSIFICATION (% of Net Assets)

As of September 30, 2015

TEKLA HEALTHCARE INVESTORS

SCHEDULE OF INVESTMENTS

SEPTEMBER 30, 2015

SHARES	CONVERTIBLE PREFERRED AND WARRANTS (Restricted) (a) (b) - 4.6%	VALUE
	Biotechnologies/Biopharmaceuticals - 1.8%	
1,426,649	Afferent Pharmaceuticals, Inc. Series C	$ 3,499,998
18,875,301	CytomX Therapeutics, Inc. Series D	2,800,000
3,696,765	EBI Life Sciences, Inc. Series A (c)	18,854
4,118,954	Euthymics Biosciences, Inc. Series A (c)	1,582,914
350,754	Merus B.V. Class C (d)	2,610,270
77,632	Neurovance, Inc. Series A (c)	424,647
965,354	Neurovance, Inc. Series A-1 (c)	5,280,485
561,798	Ovid Therapeutics Inc. Series B	3,500,002
		19,717,170
	Medical Devices and Diagnostics - 2.8%	
3,364,723	AlterG, Inc. Series C	1,379,536
114,158	CardioKinetix, Inc. Series C (c)	1,606,089
205,167	CardioKinetix, Inc. Series D (c)	781,071
632,211	CardioKinetix, Inc. Series E (c)	1,799,905
580,225	CardioKinetix, Inc. Series F (c)	1,982,281
N/A (e)	CardioKinetix, Inc. warrants (expiration 12/11/19) (c)	0
N/A (e)	CardioKinetix, Inc. warrants (expiration 6/03/20) (c)	0
12,695	CardioKinetix, Inc. warrants (expiration 8/15/24) (c)	0
3,109,861	Dynex Technologies, Inc. Series A	1,554,931
142,210	Dynex Technologies, Inc. warrants (expiration 4/01/19)	0
11,335	Dynex Technologies, Inc. warrants (expiration 5/06/19)	0
8,998,436	IlluminOss Medical, Inc. Series C-1 (c)	3,593,974
11,410,347	Insightra Medical, Inc. Series C (c)	4,830,000
8,661,370	Insightra Medical, Inc. Series C-2 (c)	3,666,358
815,025	Insightra Medical, Inc. warrants (expiration 3/31/25) (c)	0
4,482,636	Insightra Medical, Inc. warrants (expiration 5/28/25) (c)	0
3,260,100		0

	Insightra Medical, Inc. warrants (expiration 8/18/25) (c)	
3,669,024	Labcyte, Inc. Series C	2,615,647
160,767	Labcyte, Inc. Series D	133,372
3,109,861	Magellan Diagnostics, Inc. Series A	2,397,703
142,210	Magellan Diagnostics, Inc. warrants (expiration 4/01/19)	0
11,335	Magellan Diagnostics, Inc. warrants (expiration 5/06/19)	0

The accompanying notes are an integral part of these financial statements.

TEKLA HEALTHCARE INVESTORS

SCHEDULE OF INVESTMENTS

SEPTEMBER 30, 2015

(continued)

SHARES	*Medical Devices and Diagnostics - continued*	VALUE
13,823,805	Palyon Medical Corporation Series A [c]	$ 2,944
27,100,879	Palyon Medical Corporation Series B [c]	1,897
N/A [e]	Palyon Medical Corporation warrants (expiration 4/26/19) [c]	0
4,720,000	Tibion Corporation Series B	0
N/A [e]	Tibion Corporation warrants (expiration 7/12/17)	0
N/A [e]	Tibion Corporation warrants (expiration 10/30/17)	0
N/A [e]	Tibion Corporation warrants (expiration 11/28/17)	0
3,750,143	Veniti, Inc. Series A [c]	2,271,462
1,881,048	Veniti, Inc. Series B [c]	1,205,187
1,031,378	Veniti, Inc. Series C [c]	826,031
		30,648,388
	TOTAL CONVERTIBLE PREFERRED AND WARRANTS (Cost $57,165,151)	50,365,558

PRINCIPAL AMOUNT	**CONVERTIBLE AND NON-CONVERTIBLE NOTES - 0.4%** **Convertible Notes - 0.4%**	
	Medical Devices and Diagnostics - 0.0%	
$ 37,421	Palyon Medical Corporation Promissory Note, 8.00% due 12/15/15 (Restricted) [a] [c]	