

H&Q HEALTHCARE INVESTORS
Form N-CSR
December 01, 2010

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

H&Q Healthcare Investors
(Exact name of registrant as specified in charter)

2 Liberty Square, 9th Floor, Boston, MA
(Address of principal executive offices)

02109
(Zip code)

2 Liberty Square, 9th Floor, Boston, MA 02109
(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, 2009 to September 30, 2010

ITEM 1. REPORTS TO STOCKHOLDERS.

H&Q HEALTHCARE INVESTORS

Annual Report

2 0 1 0

To our Shareholders:

On September 30, 2010, the net asset value (NAV) per share of the Fund was \$14.47. During the twelve month period ended September 30, 2010, total return at NAV of the Fund was 6.20%, with distributions reinvested. During the most recent six month period ended September 30, 2010, total return at NAV of the Fund was -4.47%, with distributions reinvested. The total investment return at market with distributions reinvested was 10.04% during the twelve month period ended September 30, 2010 and -2.76% during the six month period ended September 30, 2010. As such, market performance of the Fund exceeded that for the NBI benchmark noticeably. The Fund NAV fractionally underperformed the NBI benchmark for the full fiscal year while the NAV slightly outperformed the NBI during the most recent six month period. The Fund's market return exceeded the NBI benchmark for both periods. Both the Funds' NAV and the NBI underperformed the broad S&P 500 in both periods. Comparisons to the relevant indices are listed below.

Investment Returns	Six Months Ended 9/30/10	Fiscal Year Ended 9/30/10
Investment Return at Market	-2.76%	10.04%
Net Asset Value	-4.47%	6.20%
NASDAQ Biotech Index (NBI)	-4.65%	6.61%
S&P 500 Index	-1.42%	10.12%

Portfolio Highlights

There were at least four major healthcare related themes that emerged over the last twelve months: 1) healthcare reform, 2) impact of the economic situation on healthcare, 3) FDA actions particularly with respect to drug approvals, and 4) merger and acquisition activity.

Few healthcare related events in the last ten years have played out more publicly than the recent debate surrounding healthcare reform. At its heart, this discussion involved whether and how to provide health insurance coverage for uncovered individuals. The issue divided those that believe that the United States government has a moral obligation to provide healthcare insurance to all versus those who don't feel such an obligation either for cost or philosophical reasons. In the end, the legislation was passed without popular majority approval and is now

law. This legislation appears to have been a significant factor in the most recent national elections. There are myriad views, intense on all sides, about its impact and whether it will remain law in its current form or at all. In considering the potential impact on individual healthcare sectors we agree with the consensus that the volume of healthcare related products and services will increase but that there will be pressure on prices and profit margins. In the longer term, we would expect profit margins for producers of drugs and medical devices as well as at health insurance companies to be challenged. Bundling of payments for certain classes of drugs may also challenge some drug manufacturers. On the other hand, volume increases may well benefit producers of generic drugs and possibly pharmacy benefit managers. It remains to be seen what the net effect of this legislation will be on hospital stocks, though we are pessimistic about this group particularly over the near term.

Both the healthcare reform and the overall economic situation have generated a great deal of discussion. It appears that protracted high rates of unemployment and corporate uncertainty about the fiscal and regulatory environment may have caused basic shifts in both individual and corporate behavior. There have been reports that, coincident with the economic downturn, doctor visits and elective (e.g. aesthetic and certain orthopedic) procedures are down. Furthermore, at times over the last year or two, there have been reductions in corporate purchase of capital and other laboratory equipment. It remains to be seen whether these occurrences will be sustained. For the business sector, these actions may be cyclical and may soon reverse as improvements in the business cycle gather momentum. In early/mid November 2010, the majority of companies are meeting or beating Street earnings (if not always revenue) estimates. This would suggest that the business cycle may be turning up which is supported by anecdotal evidence. It remains to be seen whether uncertainty regarding corporate taxes and regulation slows the turnaround or whether the results of the recent election reduces apparent corporate hesitancy to hire and invest. With prolonged unemployment in the range of 10% (and underemployment even higher), uncertainty remains. We would expect a reversal to occur but be delayed by a couple of years until people are more confident in their employment and home valuation situation. The impact of these trends should affect several healthcare subsectors. Reduced utilization by consumers has hurt a number of medtech companies and possibly the hospital sector. On the positive side, companies appear to be projecting more confident guidance (or at least tone) in quarterly conference calls.

It appears to us that the FDA and associated expert regulatory and reimbursement panels continue to take a very conservative approach to their review of many new products. There have been key approvals for

such drugs as Provenge for prostate cancer by Dendreon and generic Lovenox for deep vein thrombosis by Sandoz/Momenta. However, in our view, recent FDA decisions denying or substantively delaying differentiated drugs in diseases such as diabetes, obesity and respiratory disease demonstrate that important new therapies are being denied to people in need. This trend is not good for most companies we consider for investment; we would like to see the trend reverse or at least moderate.

Merger and acquisition activity in the healthcare sector continue unabated. Many completed or proposed transactions are being advanced on friendly terms and have or will likely benefit both patients and investors. Examples include the recently proposed mergers of Pfizer/King and Celgene/Abraxis. Others proposed transactions have been more fractious. The proposed acquisition of Genzyme by Sanofi is an example. In any event we continue to expect a high rate of M&A in the healthcare sector. The Fund seeks to invest in companies on both sides of such transactions and have owned shares in at least two of these exemplar deals.

With regard to the Portfolio, during the twelve month period ending September 30, 2010, Fund performance benefited from ownership of two generic drug companies, Akorn and Perrigo. The Fund also benefited from owning shares in Acorda, a manufacturer of a recently approved drug used to treat multiple sclerosis and Align, a manufacturer of dental aligners. Fund performance was also helped by ownership of Targegen, a venture holding which has been acquired. In contrast, Fund performance was hindered by its ownership of Xenoport and Intermune, companies developing drugs that were challenged during FDA review. In this period, performance was also limited by owning a significant position in Gilead, though over the long term, ownership of Gilead has benefited the Fund substantially.

Investment Changes

During the twelve month period ended September 30, 2010, within the public portfolio, the Fund established positions in several companies including Baxter International, Inc., Dendreon Corporation, Inc., Kinetic Concepts, Inc., McKesson Corporation, InterMune, Inc. Ironwood Pharmaceuticals, Inc., and VIVUS, Inc. During the same twelve month period, the Fund exited its position in several companies including Biogen Idec., United Therapeutics Corporation, Life Technologies Corporation, Intuitive Surgical, Inc., and Onys Pharmaceuticals, Inc.

During the same twelve month period, within the venture portfolio, the Fund established a position in Euthymics Biosciences, Inc. and the Fund

Edgar Filing: H&Q HEALTHCARE INVESTORS - Form N-CSR

made follow-on investments in CardioKinetix, Eleme Medical, TargeGen, Inc. and Xoft, Inc. The Fund exited its position in FlowCardia, Inc. and DOV Pharmaceutical, Inc.

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

Daniel R. Omstead
President

H&Q HEALTHCARE INVESTORS

LARGEST HOLDINGS BY ISSUER

(Excludes Short-Term Investments)

As of September 30, 2010

Issuer - Sector	% of Net Assets
Teva Pharmaceutical Industries, Ltd.	
<i>Generic Pharmaceuticals</i>	4.5%
Celgene Corporation	
<i>Biotechnologies/Biopharmaceuticals</i>	4.4%
Amgen, Inc.	
<i>Biotechnologies/Biopharmaceuticals</i>	3.8%
Gilead Sciences, Inc.	
<i>Biotechnologies/Biopharmaceuticals</i>	3.3%
Forest Laboratories, Inc.	
<i>Pharmaceuticals</i>	3.3%
CVS Caremark Corporation	
<i>Healthcare Services</i>	3.2%
PerkinElmer, Inc.	
<i>Medical Devices and Diagnostics</i>	3.2%
WellPoint, Inc.	
<i>Healthcare Services</i>	2.9%
Aetna Inc.	
<i>Healthcare Services</i>	2.7%
Align Technology, Inc.	
<i>Medical Devices and Diagnostics</i>	2.6%

SECTOR DIVERSIFICATION (% of Net Assets)

As of September 30, 2010

H&Q HEALTHCARE INVESTORS

SCHEDULE OF INVESTMENTS

SEPTEMBER 30, 2010

CONVERTIBLE SECURITIES AND WARRANTS - 8.5% of Net Assets		
Convertible Preferred		
SHARES	and Warrants (Restricted) ^(a) ^(b) - 7.9%	VALUE
<i>Biotechnology/Biopharmaceuticals - 0.2%</i>		
627,048	Euthymics Biosciences, Inc.	\$ 614,570
306,413	MacroGenics, Inc. Series D	199,812
75,217	MacroGenics, Inc. Series D 18 Month Lock-up	0
814,382		
<i>Drug Discovery Technologies - 1.3%</i>		
2,380,953	Agilix Corporation Series B ^(c)	141,809
375,000	Ceres, Inc. Series C	2,437,500
32,193	Ceres, Inc. Series C-1	209,255
280,105	Ceres, Inc. Series D	1,820,683
40,846	Ceres, Inc. Series F	265,499
8,170	Ceres, Inc. warrants (expiration 9/05/15)	0
4,874,746		
<i>Healthcare Services - 1.5%</i>		
5,384,615	PHT Corporation Series D ^(c)	4,200,000
1,204,495	PHT Corporation Series E ^(c)	939,506
149,183	PHT Corporation Series F ^(c)	116,363
5,255,869		
<i>Medical Devices and Diagnostics - 4.9%</i>		
3,424,756	CardioKinetix, Inc. Series C ^(c)	2,359,999
N/A	CardioKinetix, Inc. warrants (expiration 12/11/19) ^(c) ^(d)	0
N/A	CardioKinetix, Inc. warrants (expiration 06/03/20) ^(c) ^(d)	0
4,852,940	Concentric Medical, Inc. Series B ^(c)	2,523,529
1,744,186	Concentric Medical, Inc. Series C ^(c)	906,977
683,000	Concentric Medical, Inc. Series D ^(c)	355,160
652,013	Concentric Medical, Inc. Series E ^(c)	339,047
1,724,230	Eleme Medical, Inc. Series C ^(c)	927,636
1,877,273	Interlace Medical, Inc. Series C ^(c)	2,065,000
3,669,024	Labcyte, Inc. Series C	1,920,000
3,109,861	Magellan Biosciences, Inc. Series A	3,109,861
142,210	Magellan Biosciences, Inc. warrants (expiration 4/01/19)	0
11,335	Magellan Biosciences, Inc. warrants (expiration 5/06/19)	0
1,547,988	OmniSonics Medical Technologies, Inc. Series A-1	1,548
1,263,099	OmniSonics Medical Technologies, Inc. Series B-1	1,263

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

H&Q HEALTHCARE INVESTORS

SCHEDULE OF INVESTMENTS

SEPTEMBER 30, 2010

(continued)

SHARES	Convertible Preferred and Warrants (Restricted) ^(a) ^(b) - continued	VALUE
	<i>Medical Devices and Diagnostics - continued</i>	
13,823,805	Palyon Medical Corporation Series A ^(c)	\$ 2,211,809
65,217	TherOx, Inc. Series H	108,181
149,469	TherOx, Inc. Series I	247,939
4,220	TherOx, Inc. warrants (expiration 1/26/11)	0
8,141	TherOx, Inc. warrants (expiration 2/06/11)	0
921,875	Xoft, Inc. Series D	682,187
176,647	Xoft, Inc. Series E	130,719
N/A	Xoft, Inc. warrants (expiration 6/12/14) ^(d)	0
N/A	Xoft, Inc. warrants (expiration 6/30/15) ^(d)	0
		17,890,855
		28,835,852
PRINCIPAL AMOUNT	Convertible Notes (Restricted) ^(a) - 0.6%	
	<i>Medical Devices and Diagnostics - 0.6%</i>	
\$ 708,237	CardioKinetix, Inc., Cvt. Promissory Notes, 4.25% due 12/11/10 ^(c)	708,237
756,794	Eleme Medical, Inc., Subordinated Cvt Promissory Notes, 10.50% due 12/18/12 ^(c)	756,794
590,000	Xoft, Inc., Cvt. Promissory Notes, 10.00% due 3/31/11	590,000
74,237	Xoft, Inc., Cvt. Promissory Notes, 10.00% due 6/30/11	74,237
		2,129,268
	TOTAL CONVERTIBLE SECURITIES AND WARRANTS	
	(Cost \$47,457,606)	30,965,120
	COMMON STOCKS AND WARRANTS - 87.1%	
	Biotechnologies/Biopharmaceuticals - 30.7%	
SHARES		
162,817	Acorda Therapeutics, Inc. ^(b)	5,376,218
100,890	Alexion Pharmaceuticals, Inc. ^(b)	6,493,280
28,000	Allergan, Inc.	1,862,840
252,444	Amgen, Inc. ^(b)	13,912,189
207,326	Amylin Pharmaceuticals, Inc. ^(b)	4,322,747
5,910,745	Antisoma plc ^(b) ^(e)	558,849
118,000	Athersys, Inc. warrants (Restricted, expiration 6/08/12) ^(a) ^(b)	1,180
176,800	Baxter International, Inc.	8,435,128
280,866	Celgene Corporation ^(b)	16,180,690

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

7

H&Q HEALTHCARE INVESTORS**SCHEDULE OF INVESTMENTS**

SEPTEMBER 30, 2010

(continued)

SHARES	Biotechnologies/ Biopharmaceuticals - continued	VALUE
105,850	Cephalon, Inc. ^(b)	\$ 6,609,274
160,705	Cubist Pharmaceuticals, Inc. ^(b)	3,758,890
140,302	Dendreon Corporation ^(b)	5,777,636
547,520	Elan Corporation plc ^{(b) (e) (f)}	3,148,240
42,616	Genzyme Corporation ^(b)	3,016,787
340,308	Gilead Sciences, Inc. ^(b)	12,118,368
58,000	Human Genome Sciences, Inc. ^(b)	1,727,820
149,624	InterMune, Inc. ^(b)	2,037,879
201,780	Ironwood Pharmaceuticals, Inc. ^(b)	2,054,120
148,216	Martek Biosciences Corporation ^(b)	3,354,128
300,178	Neurocrine Biosciences, Inc. ^(b)	1,819,079
14,750	Orexigen Therapeutics, Inc. ^(b)	87,465
121,940	Vertex Pharmaceuticals, Inc. ^(b)	4,215,466
423,547	VIVUS, Inc. ^(b)	2,833,530
362,685	XenoPort, Inc. ^(b)	2,578,690
		112,280,493
	Drug Discovery Technologies - 0.1%	
13,729	Clinical Data, Inc. ^(b)	231,604
70	Zyomyx, Inc. (Restricted) ^{(a) (b)}	18
		231,622
	Generic Pharmaceuticals - 10.2%	
1,321,151	Akorn, Inc. ^(b)	5,337,450
202,223	Akorn, Inc. warrants (Restricted, expiration 3/08/11) ^{(a) (b)}	76,845
96,461	Impax Laboratories, Inc. ^(b)	1,909,928
360,898	Mylan, Inc. ^(b)	6,788,491
106,376	Perrigo Company	6,831,467
310,252	Teva Pharmaceutical Industries, Ltd. ^(f)	16,365,793
		37,309,974
	Healthcare Services - 18.3%	
317,221	Aetna Inc.	10,027,356
222,222	Aveta, Inc (Restricted) ^{(a) (g)}	2,222,220
124,600	Charles River Laboratories International, Inc. ^(b)	4,130,490
376,200	CVS Caremark Corporation Laboratory Corporation of America Holdings	11,839,014
115,581	^(b)	9,065,018
58,500	McKesson Corporation	3,614,130
154,314	Medco Health Solutions, Inc. ^(b)	8,033,587
300,452	Pharmaceutical Product Development, Inc.	7,448,205
185,959	WellPoint, Inc. ^(b)	10,532,717

