EDISON

The Biotech Growth Trust

Policy tweaked for greater flexibility

Investment trusts

The Biotech Growth Trust provides exposure to both major and emerging biotech companies and has a strong long-term record of outperformance against its benchmark, the NASDAQ Biotechnology Index (NASBIOT). Sector drivers, including ageing populations, important new scientific discoveries and acceleration in new product development, are supportive and recent amendments to BIOG's investment policy will allow the manager greater flexibility to invest in large-cap biotech names. Biotech valuations have expanded, but in the manager's view are still reasonable given the sector's growth prospects. PEG ratios are attractive.

12 months ending	Total share price return* (%)	Total NAV return* (%)	Total return NASBIOT Index* (%)	Total return RGUHSBTG Index* (%)	Total return DS World Pharma & Biotech Index* (%)
31/12/10	15.5	17.2	16.4	15.5	7.5
31/12/11	14.6	18.0	13.1	(2.6)	11.3
31/12/12	50.6	38.9	26.7	8.4	13.0
31/12/13	60.1	63.5	63.1	51.7	34.2

Note: *Twelve-month rolling discrete performance.

Investment strategy: Major and emerging biotech

The Biotech Growth Trust (BIOG) maintains a portfolio that is split 47% major biotech, 32% emerging biotech, with the balance in speciality pharma and life science tools companies. For the emerging part of the portfolio, manager OrbiMed will typically invest during the development process, two to three years before product approval or launch. This is likely to produce sales and sustainable profitability, which acts as a significant catalyst for share price improvement. Within major biotech, OrbiMed looks for companies with healthy growth from existing products and strong pipelines to provide future growth.

Sector outlook: Growing market, valuations rising

The healthcare and biotech sectors benefit from a favourable demographic backdrop with increasing demand from ageing populations, particularly in the western world, and growth in population and utilisation, particularly in emerging markets. The biotech sector has performed strongly during the last five years and particularly during the last two years, when the sector has experienced a significant re-rating. The expansion of valuations potentially leaves the sector more open to a correction, but the manager considers that, particularly for the large cap names, valuations are not stretched and that large cap biotech's premium over large cap pharma is warranted by its superior growth prospects (see page 5).

Valuation: Increased volatility over six months

Having frequently traded at a premium during the year to June 2013, BIOG's discount broadly widened during H213, although this has recently reversed. The trust's current premium of 0.2% compares with a three-year discount average of 3.8% (one-year range a premium of 3.8% to a discount of 10.3%). BIOG's clear discount maintenance policy suggests the risk of a substantial expansion beyond the near-term range is limited. Improved sentiment and continued outperformance could see a narrower discount/modest premium being sustained.

20 January 2014

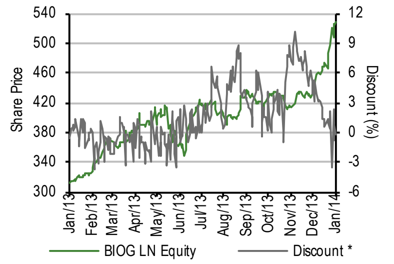
Price	**528.00p**
Market cap*	**£363m**
AUM	**£393m**

NAV*	526.83p
Premium to NAV	0.2%
Yield	0.0%

Including and excluding income, as at 17 January 2014.

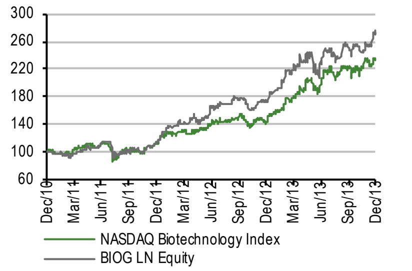
Ordinary shares in issue	68.8m
Code	BIOG
Primary exchange	LSE
AIC sector	SS: Biotech/Life Sciences

Share price/discount performance



** Positive values indicate a discount; negative values indicate a premium.*

Three-year cumulative perf. graph



52-week high/low	528.00p	313.50p
NAV* high/low	527.60p	310.94p

Including income.

Gearing

Gross	10.0%
Net	10.0%

Analysts

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Edison profile page

The Biotech Growth Trust is a research client of Edison Investment Research Limited

Exhibit 1: Trust at a glance

Investment objective and fund background

The Biotech Growth Trust seeks capital appreciation through investing in the worldwide biotechnology industry. Performance is measured against its benchmark index, the NASDAQ Biotechnology Index (sterling adjusted).

Recent developments

9 December 2013: Supplementary prospectus in relation to allotment of new shares published.

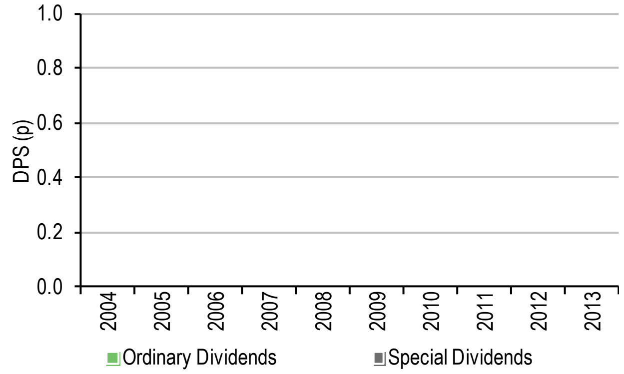
29 November 2013: Interim report for the half-year ended 30 September 2013 released.

30 October 2013: EGM approves investment policy changes removing the restriction that a majority of holdings must have a market cap less than US$3bn.

Forthcoming		Capital structure		Fund details	
AGM	July 2014	Ongoing charges	1.3%	Group	Frostrow Capital LLP
Preliminary results	June 2014	Net gearing	10.0%	Manager	OrbiMed Capital
Year end	31 March	Annual mgmt fee	See Page 7	Address	25 Southampton Buildings, London, WC2A 1AL, UK
Dividend paid	N/A	Performance fee	See Page 7		
Launch date	June 1997	Trust life	Indefinite	Phone	+44 (0)20 3008 4910
Continuation Vote	Vote every five years	Loan facilities	See Page 7	Website	www.biotechgt.com

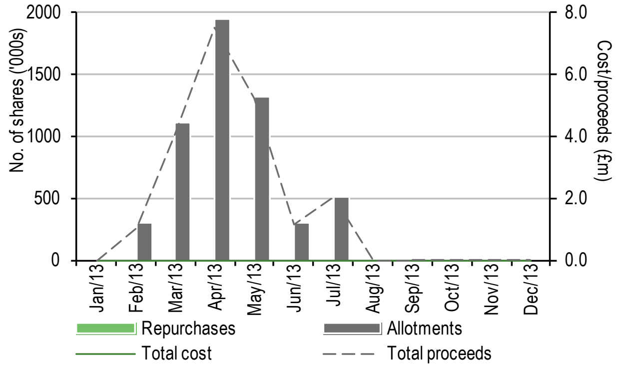
Dividend policy and history

Reflecting the capital appreciation objective, dividends are paid only as required to maintain BIOG's investment trust status. Dividends, if any, are expected to be small (last dividend of 0.2p paid in 2001).

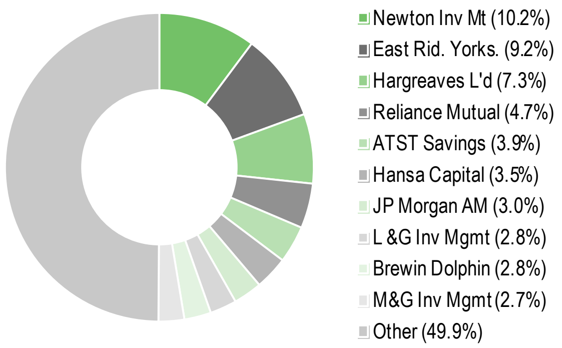


Share buyback policy and history

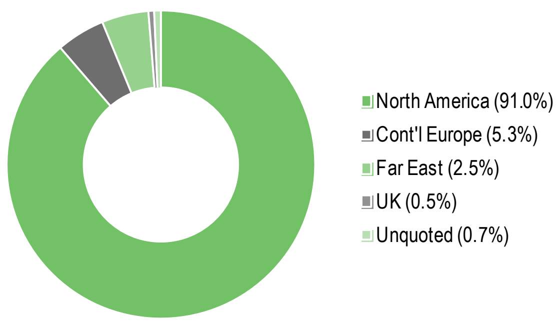
Renewed annually, the trust has authority to purchase up to 14.99% and allot up to 10% of issued share capital.



Shareholder base (as at 31 December 2013)



Distribution of portfolio (as at 31 December 2013)



Top 10 holdings (as at 31 December 2013)

Company	Country	Sector	Portfolio weight (%) 30 December 2013	Portfolio weight (%) 30 June 2013
Gilead Sciences	US	Biotech & pharma/Biotech	10.0	9.1
Celgene	US	Biotech & pharma/Biotech	9.7	7.6
Biogen Idec	US	Biotech & pharma/Biotech	9.0	8.0
Regeneron Pharmaceuticals	US	Biotech & pharma/Biotech	5.9	7.5
Incyte	US	Biotech & pharma/Biotech	5.6	4.6
Ono Pharmaceutical	Japan	Biotech & pharma/Specialty pharmaceuticals	4.9	2.0
Amgen	US	Biotech & pharma/Biotech	3.9	9.2
Illumina	US	Life science equipment	3.6	3.6
Impax Laboratories	US	Generic pharmaceuticals	3.0	2.3
Alexion Pharmaceuticals	US	Biotech & Pharma/Therapeutics	2.8	2.3
Top 10			**58.4**	**59.8**
Cash			**0.0**	**0.0**

Source: The Biotech Growth Trust, Edison Investment Research.

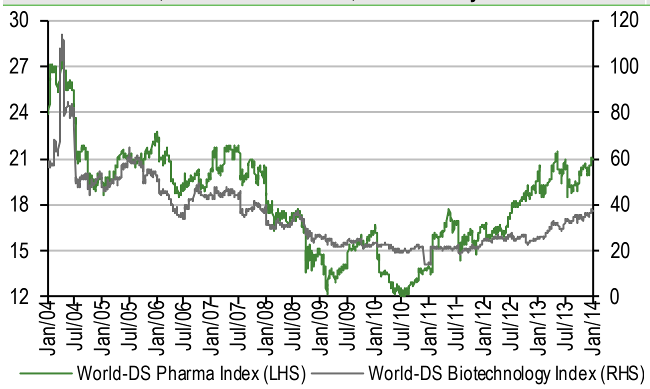
Equity outlook: Growing market, valuations rising

Healthcare and biotech are exposed to favourable demographic trends of rising demand from growth in both population and utilisation, particularly in emerging markets, and from ageing populations, particularly in the western world. Large cap pharma is the largest subsector within the healthcare space. It has traditionally experienced success in sales and marketing, but despite making significant expenditure on R&D it has suffered from poor R&D productivity in recent years and has found it difficult to replace revenues that have been lost as drugs have gone off-patent. By contrast, biotech companies have experienced stronger R&D success. This has seen a trend towards large cap pharma and biotech companies being increasingly dependent on drugs that have been sourced externally – typically from emerging biotech companies. The returns for discovering treatments that are effective can be substantial, but development risks are high. This high risk, coupled with the need to understand the complex science that frequently determines product failure or success, are strong arguments for investing via a portfolio managed by sector experts.

With the NASBIOT up 181% in sterling-adjusted total return terms during the last five years, the biotech sector has provided a strong run of performance. A significant re-rating has occurred in the last two years, during which time the NASBIOT has risen 107%. Initially, price rises were matched by earnings increases and so valuations remained near their historic lows, but the last two years has seen an expansion in multiples (for example, the P/E has risen from c 24x to c 37x), which potentially leaves the sector more vulnerable to a correction. Our analysis shows there have been five significant corrections during the past five years, which on average have seen the NASBIOT fall 17% and, while in each case the biotech has subsequently recovered the fall, the recent run of strong performance has led to talk of a biotech bubble. Looking at Exhibit 2, we can see that biotech P/E ratios traded at a premium to the total US market from 2003 to 2009, although this premium was on a declining trend, with parity reached in 2009. Since that time, the trend has broadly been one of an expanding premium to the market, although the premium remains below its 10-year average. Current pharma and biotech P/Es (37.1x for the World-DS Biotech Index and 21.0x for the World-DS Pharma index) remain broadly in line with their 10-year averages (35.4x and 18.2x). Continued progress for biotech from here is likely to depend on the sector's ability to match or beat estimated earnings growth. The favourable secular drivers outlined above could support this.

Exhibit 2: Healthcare sector valuations

World-DS Pharma, and World-DS biotech, P/Es over 10 years



World-DS Biotechnology P/E relative to US-DS Market P/E over 10 years

Source: Thomson Datastream

Fund profile: Focused biotechnology portfolio

Launched in June 1997, a new mandate was adopted in May 2005 and OrbiMed Capital appointed as investment adviser. OrbiMed is the largest independent specialist investor in the biotechnology and pharmaceutical sectors with assets under management of c $9bn.

Revised investment policy and new share issuance

At an EGM on 30 October 2013, shareholders approved changes to BIOG's investment policy, which reflects the evolution of the biotech sector. The most significant is the removal of the previous restriction that a majority of the portfolio is invested in biotechnology companies with a market capitalisation below US$3bn. The restriction had ensured that the portfolio was tilted towards emerging biotech, but following a strong performance by the sector, as well as a maturing of the biotech sector during the last five years, the managers felt that US$3bn no longer provided an appropriate cut-off. Furthermore, while they still favour emerging biotech, they consider the outlook for major biotech is positive and that there could be more opportunities in major biotech going forward. Similarly, the related restriction that the largest 30 quoted stocks represent at least 50% of the quoted portfolio was also removed. An adjustment was also made to give BIOG greater flexibility to use swaps. Previously, it could invest up to 5% of the portfolio in India with exposure to be gained through swaps. Now, where BIOG is not able to invest directly in certain countries, exposure may be gained through swaps, although the total swaps exposure will not exceed 5%. The directors considered that it was no longer appropriate to limit swap exposure to one particular country, particularly as BIOG does not have any exposure to India directly or indirectly through swaps.

December 2013 saw a supplementary prospectus released in relation to the allotment of up to £50m new shares to be issued at a premium via regular tap issues. Any new shares issued should benefit existing holders by increasing the liquidity of the trusts' shares and reducing its ongoing charges, as fixed costs are spread over a larger asset base.

The fund managers: Richard Klemm and Geoffrey Hsu

The manager's view: Valuations reflect underlying growth

The managers acknowledge recent multiple expansion, but consider that as biotech P/Es are broadly in line with their long-term averages, the sector is not in a bubble and valuations, particularly for the large caps, are not stretched. They caution that for certain small and mid–cap companies, with early stage compounds, the market is potentially factoring in too high a probability of success, but they are avoiding these names and consider there are still many opportunities to purchase companies with high-quality assets at attractive valuations. Moreover, the longer-term stories of favourable demographics and innovation remain intact and with significant investment in R&D as well as the development of new technologies, biotech has matured as a sector and is now cash flow positive while enjoying improved rates of R&D success. The managers strongly believe that large cap biotech's current P/E premium over large cap pharma is justified by biotech's superior growth prospects. As illustrated in Exhibit 3, looking forward to 2017 earnings, price earnings multiples are more comparable (15.1x vs 13.3x), but biotech offers more favourable PEG ratios. In terms of key product areas, the managers continue to see substantial opportunities from developments in cancer immunotherapy (liquid and solid tumours), multiple sclerosis and obesity.

Exhibit 3: Large-cap biotech and pharma P/E multiples, as at 14 January 2014

Top biotech	IBES LT EPS CAGR (%)	Current P/E	Forward P/E	2016 P/E	2017 P/E	Forward PEG	Top pharma	IBES LT EPS CAGR (%)	Current P/E	Forward P/E	2016 P/E	2017 P/E	Forward PEG
Amgen	9.2	15.6	14.3	13.2	12.2	1.6	Pfizer	5.0	0.0	13.4	12.8	12.9	2.7
Gilead	34.5	36.7	22.7	14.0	10.8	0.7	JNJ	6.9	17.2	16.1	15.0	14.0	2.3
Biogen IDEC	21.1	32.0	24.4	20.2	16.7	1.2	Merck	2.3	15.2	15.2	14.2	13.4	6.8
Celgene	23.4	27.5	22.6	17.3	13.5	1.0	Abbvie	1.5	15.8	15.7	13.7	12.4	10.5
Alexion	29.1	42.9	38.0	30.3	23.8	1.3	Bristol Myers	12.5	31.8	30.9	32.2	28.5	2.5
Regeneron	28.5	33.8	27.9	26.1	24.6	1.0	Lilly	1.3	12.6	18.6	16.3	13.2	14.1
Median	**25.9**	**32.9**	**23.6**	**18.8**	**15.1**	**1.1**	**Median**	**3.6**	**15.5**	**15.9**	**14.6**	**13.3**	**4.7**

Source: IBES, Bloomberg.

Asset allocation

Investment process: Extensive fundamental research

In managing BIOG's portfolio, the manager is able to draw on the extensive resources and expertise of OrbiMed's team of over 70 investment professionals with strong backgrounds in science, medicine, life sciences, finance and law. The investment process is driven by extensive fundamental research that includes detailed analysis of a company's fundamentals and the science underpinning the investment thesis. Team members are specialists in either public or private equity. Within these broad areas, analysts further specialise in disease areas, industry subsectors and geographic regions. OrbiMed seeks to apply its scientific expertise to predicting a favourable balance of outcomes with respect to clinical studies, drug trial results and the commercial success of product introductions. For the emerging part of the portfolio c 32%, OrbiMed will typically invest during the development process, two to three years before FDA approval or launch. This is likely to produce sales and sustainable profitability, which acts as a significant catalyst for share price improvement. Exits often occur once the market starts to become more confident of the future prospects for investee companies and begins to value them accordingly. Within the major biotech part of the portfolio, OrbiMed looks for companies with healthy growth from existing products and strong pipelines to provide future growth. In terms of investment restrictions, a maximum of 10% of the portfolio (at the time of acquisition) can be invested in unquoted companies, total investment in UK-listed investment companies are limited to not more than 15% of gross assets; investment in any one stock is limited to 15% of the portfolio at the time of acquisition, and a maximum of US$15m can be invested in private equity funds managed by OrbiMed or an affiliate.

Overview

BIOG had 40 equity investments, with the top 10 holdings accounting for 58.5% of the portfolio, as at 31 December 2013. Most of the portfolio (88.7%) is invested in US stocks and BIOG therefore has a significant exposure to the dollar. The portfolio is split 46.5% major biotech, 31.5% emerging biotech, 12.3% speciality pharma and 9.7% life science tools companies.

Recent activity and current portfolio positioning

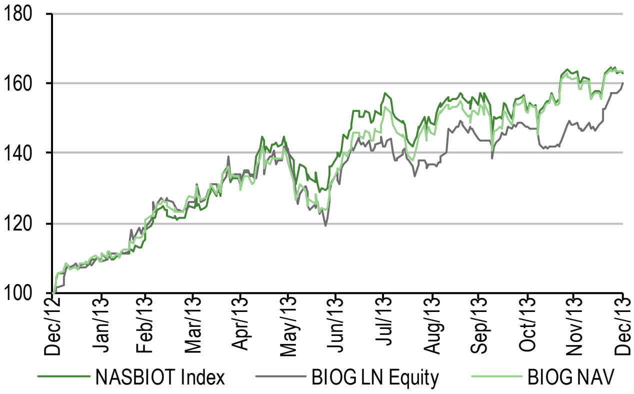
US biotech stocks are the largest element of the portfolio at 88.7%, with Continental Europe, the Far East, UK and unquoted holdings accounting for 5.1%, 4.9%, 0.6% and 0.7% respectively. The half year to 30 September saw 12 names exit the portfolio while eight new names were added. Intermune, Techne, Exelixis and Portola Pharma were the largest of the new additions as at 30 September, while Acorda Herapeutics, Warner Chilcott, 3SBio and Actelion represent the most significant exits since 31 March. BIOG has benefited from two recent acquisitions. Astex was acquired by Otsuka Pharma in October, while Onyx was acquired by Amgen in August.

Performance: Strong record of outperformance

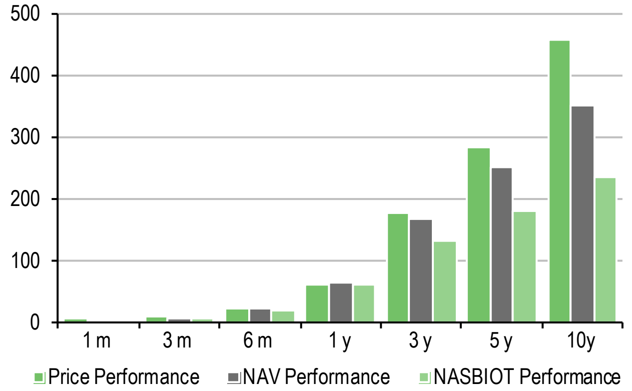
As Exhibits 4, 5 and particularly 6 illustrate, BIOG has delivered significant long-term outperformance against the NASBIOT and other biotech benchmarks provided. Over one year, NAV performance has been affected by a period of difficult performance between the beginning of April and early June. In April, BIOG's overweight in Celgene detracted from performance; weak sales of Revlimid led to disappointing Q1 results, while the major cause of underperformance during May and June was an overweight in Infinity Pharmaceuticals. Information surfaced in May suggesting a competing drug to Infinity's IPI-145 Idelalisib had better efficacy than expected. Then in June, updated phase I data confirmed IPI-145's efficacy, but suggested that its safety profile was less favourable concerning infections, when compared to other drugs in development. The stock is yet to fully recover, but the managers believe that the toxicity of the compound can be managed and are maintaining BIOG's holding. The managers think Infinity is undervalued at the current share price, but have not added to the holding because of liquidity constraints. Funds managed by OrbiMed represent the second largest shareholder with 9.5% of Infinity's stock.

Exhibit 4: Investment trust performance to 31 December 2013

Price, NAV and benchmark total return perf, one year rebased



Price, NAV and benchmark total return performance (%)



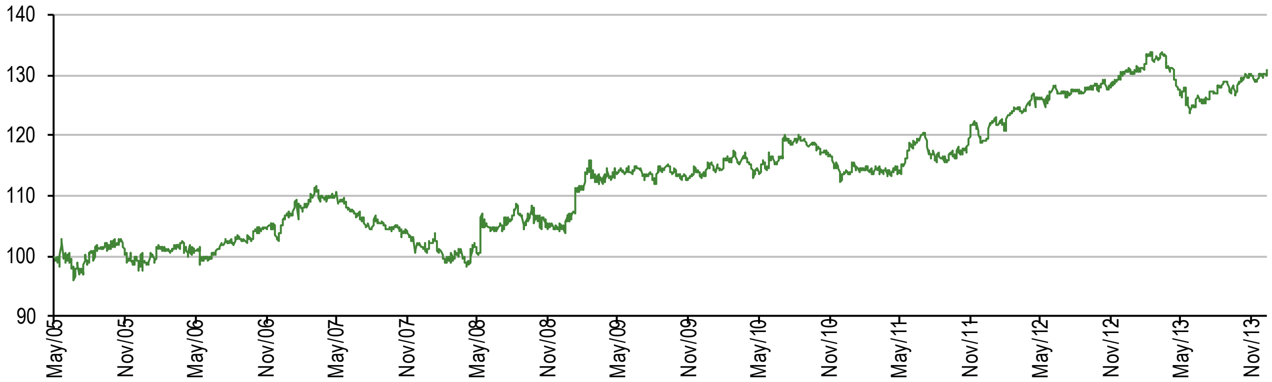
Source: Morningstar, Edison Investment Research

Exhibit 5: Share price and NAV total return performance, versus benchmarks (% points), to 31 December 2013

	One month	Three months	Six months	One year	Three years	Five years	OrbiMed*
Price versus NASBIOT	7.8	5.2	1.5	(3.0)	42.8	101.9	132.0
NAV versus NASBIOT	1.4	2.2	4.5	0.4	34.2	71.3	112.4
Price versus Russell 2000 Biotech Growth	6.5	11.6	7.8	8.4	116.4	166.3	300.0
NAV versus Russell 2000 Biotech Growth	0.1	8.5	10.8	11.8	107.8	135.7	280.4
Price versus DS World Pharma & Biotech	8.0	5.2	14.5	25.9	107.7	193.7	244.6
NAV versus DS World Pharma & Biotech	1.6	2.1	17.6	29.3	99.1	163.1	225.0
Price versus FTSE All-Share	6.1	5.7	10.1	39.3	145.5	187.7	299.6
NAV versus FTSE All-Share	(0.3)	2.7	13.1	42.7	136.9	157.1	280.0

Source: The Biotech Growth Trust, Thomson Datastream, Edison Investment Research. Note: * OrbiMed measurement period is from 19 May 2005 when OrbiMed Capital was appointed as BIOG's manager.

Exhibit 6: BIOG NAV total return vs NASBIOT total return, since OrbiMed has managed BIOG, rebased to 100



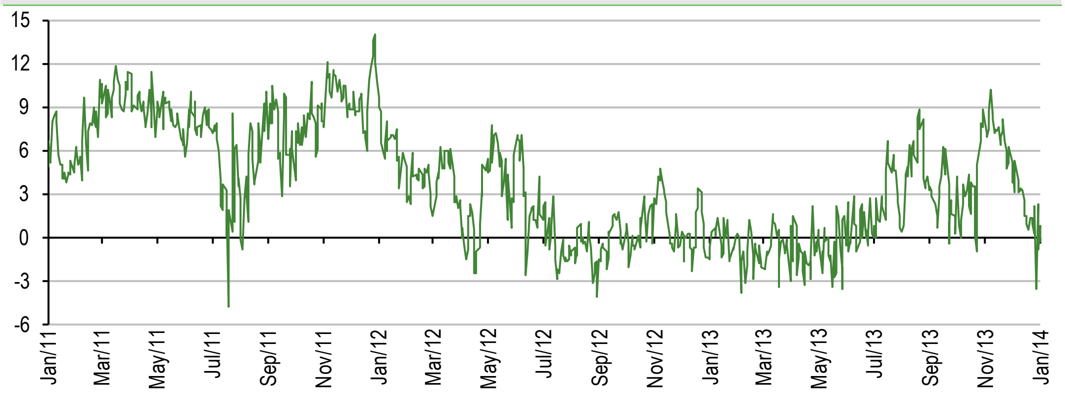
Source: The Biotech Growth Trust, Thomson Datastream, Edison Investment Research

Discount: Moved back to trade at a premium

Having frequently traded at a premium between June 2012 and June 2013, BIOG's discount broadly widened during H213, while its volatility has also increased. The widening followed a period of weaker relative performance by the trust during April and May, which largely wiped out any gains in NAV during the previous 12 months. While much of this underperformance has since been regained, this shift in fortunes may have served to unsettle certain investors at a time when the Biotech sector had already made substantial gains, valuations had expanded, and talk of a potential bubble in the sector had surfaced. The discount led to a curtailment of new issuance by the trust but, following a period of sustained outperformance, BIOG is once again trading at a premium and there has recently been some new issuance.

A policy of actively managing the discount to broadly maintain it within 6.0% of the NAV was introduced in 2005, with a view to making the company's shares more attractive to new investors and generating a sustained improvement in the rating of its shares. This policy has been effective, with BIOG trading at an average discount since OrbiMed's appointment in August 2005 of 4.6%. The current premium of 0.2% compares to BIOG's discount average over five years of 4.8% and BIOG's clear discount maintenance policy suggests that the risk of a substantial expansion beyond the one-year range is limited. Moreover, improved sentiment as well as a further period of outperformance could see a narrower discount/modest premium being sustained.

Exhibit 7: Discount over three years



Source: Thomson Datastream, Edison Investment Research; *Note: Positive values indicate a discount; negative values indicate a premium.

Capital structure: Conventional, currently ungeared

BIOG is a conventional trust, having only one class of share in issue – 25p ords. BIOG can borrow up to a maximum of £15m and it has a loan facility with Goldman Sachs & Co. As at 31 December 2013, BIOG had gross and net gearing of 10.0%. OrbiMed receives an investment management fee of 0.65% of net assets per year. Frostrow's management fee is equal to a fixed amount of £50,000 per year plus 0.30% pa of the company's market capitalisation. There is a performance fee of 16.5% of any outperformance of the NAV over the benchmark index, the NASDAQ Biotechnology Index (sterling adjusted). The performance fee, calculated quarterly, is based on the lower of the cumulative outperformance of the investment portfolio against the benchmark since June 2005, or the cumulative outperformance of the investment portfolio against the benchmark over the previous 12 months. Where a performance fee is payable, OrbiMed receives 15.0% and Frostrow Capital receives 1.5% of the outperformance. BIOG's ongoing charges were 1.3% for the year ended 31 March 2013 (1.3% for the year ended 31 March 2012). As Exhibit 8 shows, BIOG's ongoing charges are comparable to those of its peers. The management contract can be terminated at one year's notice by either party. The life of the trust is indefinite. However, at every fifth AGM, a continuation vote will be put to shareholders. The next vote is due at the 2015 AGM.

Dividend policy and record: None, capital growth focus

BIOG's investment objective is to achieve capital growth by investing in the global biotechnology industry. Such companies will, if successful, be at a growth stage in their development and will typically retain earnings in full for reinvestment. As such, BIOG's dividend income is small in relation

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to movements in the capital reserve and is more than offset by expenses that are charged against it. BIOG has not paid a dividend for over 10 years.

Peer group comparison

Exhibit 8: Biotechnology and life sciences sector, as at 13 January 2014

Company *	Share price total return on £100				Ongoing charges (%)	(Disc)/ prem. (%)	Net gearing (100=no gearing)	Five-year dividend growth (%)	Div. yield (%)	Sharpe ratio NAV one year	Sharpe ratio price one year	NAV volatility one year	Price volatility one year
	One year	Three years	Five years	Ten years									
Biotech Growth Trust	165.6	303.2	428.0	497.7	1.3	3.5	110.0	0.0	0.0	2.6	2.5	22.1	23.2
International Biotechnology	150.1	208.5	239.8	263.3	1.7	(9.1)	101.0	0.0	0.0	2.0	2.9	19.2	13.2
Polar Capital Global H'care	118.0	153.8			1.1	(6.3)	100.0	0.0	2.3	2.1	1.3	9.0	15.1
Worldwide Healthcare Trust	146.6	191.8	252.2	206.8	0.7	(4.3)	111.0	27.0	1.3	2.8	3.9	13.4	14.0
BB Biotech AG	168.9	279.2	294.0	403.0	1.5	(26.5)	105.0	400.0	2.9	2.9	3.6	23.9	22.6
Sector weighted average	**159.3**	**250.9**	**299.4**	**460.1**	**1.3**	**(15.2)**	**106.5**	**287.4**	**2.4**	**2.7**	**3.4**	**20.1**	**19.7**
Biotech Growth Rank**	2	1	1	1	3	1	2	3	4	3	4	2	1
Number in group	6	6	5	5	6	6	6	6	6	6	6	6	6

Source: Morningstar. *Note: All the peers shown are UK-listed with the exception of BB Biotech AG (primary listing in Switzerland). **Note: Ranked in descending size order.

Exhibit 8 provides a peer group comparison for the biotechnology/life sciences specialist sector. The peer group is relatively small (five constituents), and while all trusts invest in biotechnology companies, their investment objectives are markedly different. Within this peer group BIOG ranks second over one year (first for the UK listed peers), and first over three, five and 10 years when considering share price total return. BIOG has the third highest one-year Sharpe ratio for NAV and the fourth highest Sharpe ratio for price.

The board

All directors are non-executive and all, excluding Sven Borho, are independent of the investment manager. Sven Borho is a founding partner of the manager OrbiMed Capital. The directors, with year of appointment as director in brackets, are The Rt Hon Lord Waldegrave of North Hill (independent non-executive chairman, 1998), Dr John Gordon (senior independent non-executive director, 1997), Professor Dame Kay Davies (2012), Andrew Joy (2012), Peter Keen (1997), Paul Gaunt (1997) and Sven Borho (2006). The average length of director service is 9.6 years.

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