

International Biotechnology Trust

Dual portfolio drives recent outperformance

International Biotechnology Trust (IBT) is an established investor in the high-growth area of biotechnology. It is differentiated from peers by including unquoted companies (<10% of assets) alongside quoted holdings. The biotech sector seems largely to have shrugged off recent criticism over excessive pricing in some areas and long-term performance has been impressive, with the benchmark NASDAQ Biotech Index up 304% over five years compared with a return of 45% for the FTSE All-Share. IBT has outperformed the benchmark over one and two years under new manager Carl Harald Janson and is top of its peer group for one-year NAV total returns; the discount to NAV, while in line with averages, remains wider than peers, suggesting a relative valuation opportunity.

12 months ending	Share price (%)	NAV (%)	NASDAQ Biotech (%)	MSCI World Healthcare (%)	FTSE All-Share (%)
30/11/11	10.2	5.7	16.3	11.0	2.6
30/11/12	30.0	34.6	33.9	19.5	12.1
30/11/13	47.5	38.2	58.7	33.3	19.8
30/11/14	43.3	45.7	42.4	28.7	4.7
30/11/15	26.5	23.6	14.8	7.0	0.6

Note: Twelve-month rolling discrete £-adjusted total return performance.

Investment strategy: Seeking strong candidates

IBT blends investment in quoted (>90%) and unquoted biotechnology companies. The managers of the quoted portfolio seek attractively valued companies with strong management and innovative, wholly owned assets, addressing high unmet medical need. Potential investments should demonstrate strong and differentiated intellectual property, with pricing power in growing markets. In the unquoted portfolio, companies may have been started or incubated by the SVLS venture team, although to reduce risk they are not usually considered for inclusion in IBT until there is proof of concept.

Market outlook: Earnings underpin price gains

Biotech stocks have outperformed most other sectors over recent years, but sold off in late September on criticism of unfair pricing practices by an unlisted US firm. Notwithstanding political pressure on drug pricing, the sector is arguably well placed to continue to innovate, and valuations (12m median forward P/E of 17.8x for the six largest biotech stocks) remain comparable with the broader health sector (top six stocks 15.2x) and the US market as a whole (16.9x), while earnings forecasts remain strong (13.4% median compound annual growth rate).

Valuation: Discount average, supported by buybacks

At 10 December IBT's shares stood at an 11.6% discount to cum-income net asset value. This is broadly in line with the one-, three- and five-year averages of 10.9%, 13.7% and 13.7%. Following a large share buyback in November 2014 (5.9m or 13.4% of shares) to facilitate the exit of a major shareholder, the board has continued with ad hoc buybacks; so far in 2015, 2.6m shares have been repurchased at a cost of £13.0m. The willingness of the board to act as a marginal buyer should give reassurance that material widening in IBT's discount is unlikely except in the event of market dislocation.

Investment trusts

11 December 2015

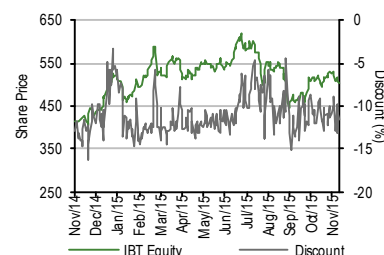
Price 505.5p
Market cap £200.8m
AUM £229.1m

NAV* 573.8p
Discount to NAV 11.9%
NAV** 571.6p
Discount to NAV 11.6%

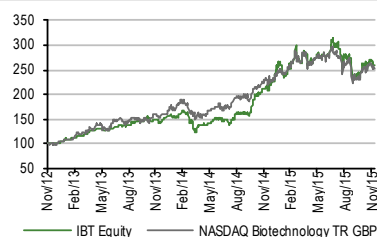
*Excluding income. **Including income. Data at 10 December.

Yield 0.0%
Ordinary shares in issue 39.7m
Code IBT
Primary exchange LSE
AIC sector SS: Biotech & Healthcare

Share price/discount performance



Three-year cumulative perf. graph



52-week high/low 620.0p 405.0p
NAV** high/low 670.4p 467.2p

**Including income.

Gearing

Gross* 9.2%
Net* 4.6%

*At year-end, 31 August 2015.

Analysts

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[Edison profile page](#)

Exhibit 1: Trust at a glance

Investment objective and fund background

International Biotechnology Trust aims to achieve long-term capital growth by investing in biotechnology and other life sciences companies, both quoted and unquoted, that have high growth potential. IBT invests in companies considered to have good prospects, experienced management and strong upside potential through the development and/or commercialisation of a product, device or enabling technology. Reflecting its capital appreciation objective, IBT's current policy is not to pay dividends.

Recent developments

- 5 November 2015: Annual results for the 12 months ended 31 August. NAV TR +48.2% versus +33.6% for the benchmark NASDAQ Biotech Index (in £). Share price TR +75.4%.
- 14 April 2015: Half-year results for the six months ended 28 February. NAV per share +44.5% and share price +57.4% over the period.
- 1 April 2015: Caroline Gulliver appointed to the board of IBT. She is a chartered accountant and retired from Ernst & Young in 2012.

Forthcoming

AGM	December 2016
Interim results	April 2016
Year end	31 August
Dividend paid	N/A
Launch date	May 1994
Continuation vote	Two-yearly, next 2017

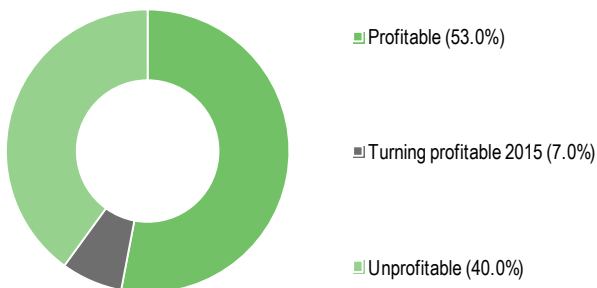
Capital structure

Ongoing charges	1.5%
Gearing	4.6% net
Annual mgmt fee	0.9% of net assets
Performance fee	See page 7
Trust life	Indefinite
Loan facilities	Up to £35m

Fund details

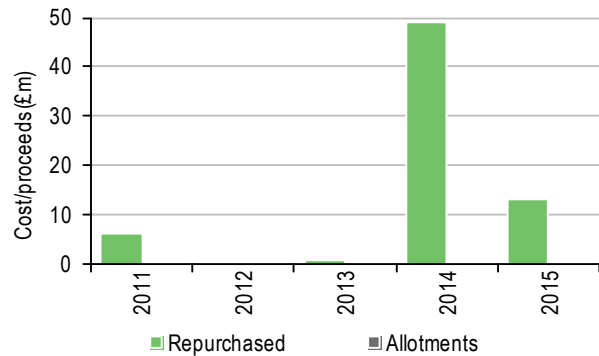
Group	SV Life Sciences
Managers	Carl Harald Janson, Ailsa Craig, Kate Bingham
Address	71 Kingsway, London, WC2B 6ST, UK
Phone	+44 (0)20 7421 7070
Website	www.ibtplc.com

Distribution by development stage as at 31 October 2015

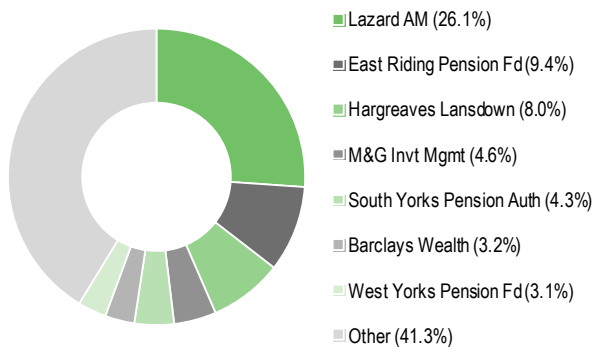


Share buyback policy and history

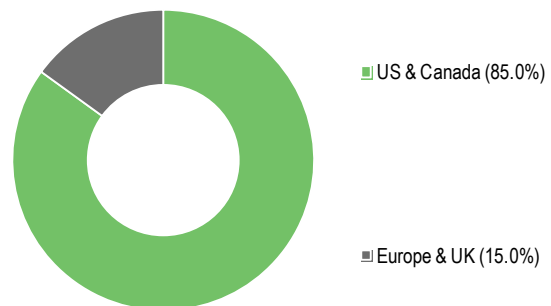
Renewed annually, the trust has authority to purchase up to 14.99% and allot up to 5.0% of issued share capital.



Shareholder base (as at 4 November 2015)



Geographical distribution (as at 31 October 2015)



Top 10 holdings (as at 31 October)

Company	Country of listing	Sector	Portfolio weight %	
			31 Oct 2015	30 April 2015*
Amgen	US	Oncology/autoimmune diseases	8.0	7.6
Celgene	US	Oncology/inflammatory diseases	8.0	6.8
Gilead	US	Infectious diseases	7.8	7.5
Regeneron	US	Ophthalmic disorders	7.8	6.4
Ophthotech	US	Ophthalmic disorders	4.9	N/A
Biogen	US	Oncology/inflammatory diseases	4.7	6.9
Vertex	US	Orphan/infectious diseases	4.1	3.5
Alexion	US	Orphan diseases	4.0	4.7
Incyte	US	Oncology	3.1	N/A
Biomarin	US	Orphan diseases	2.9	2.9
Top 10 (% of portfolio)			55.3	53.3

Source: International Biotechnology Trust, Edison Investment Research, Morningstar, Thomson Datastream, Bloomberg. Note: *N/A where not in 30 April 2015 top 10.

Market outlook: Bouncing back from controversy

Over five years to 30 November the NASDAQ Biotech Index has produced a sterling total return of 303.9%, compared with 45.2% for the FTSE All-Share. However, the sector was caught up in the market sell-off in August and saw further declines in September when a minor US specialty pharma firm hiked the price of an off-patent medicine by more than 5,000%. This sparked an angry response from the public and US politicians including Hillary Clinton, and the index fell by nearly 9% in a week.

Proponents of biotech point to its superior growth rate compared with 'big pharma', driven by clinical innovation, and valuations that are broadly comparable (Exhibit 2). Advances in understanding disease processes should underpin product development, coupled with increasing medical need and access to treatment as populations age and developing countries become more prosperous. M&A activity could also continue as the big drug companies seek to benefit from biotech innovation. (Amgen reportedly has \$10bn to invest in M&A, Biogen has raised \$5bn of debt financing that could be used for acquisitions, and Gilead is known to have a \$25bn 'war chest'.) Against this investors should weigh the possibility of a further pricing backlash, as well as the level of broader stock market uncertainty. In uncertain times, a diversified portfolio of biotech companies managed by clinical specialists could provide a smoother ride than simple index exposure.

Exhibit 2: Large-cap biotech and pharma historical and estimated P/E multiples (at 27 November 2015)

Big biotech	2015-18 EPS CAGR (%)	2015 P/E	2016 P/E	2017 P/E	2018 P/E	Forward PEG	Big pharma	2015-18 EPS CAGR (%)	2015 P/E	2016 P/E	2017 P/E	2018 P/E	Forward PEG
Alexion	23.1	36.7x	32.9x	25.1x	19.7x	1.5	Abbvie	15.6	14.0x	11.9x	10.1x	9.0x	1.2
Amgen	7.7	16.2x	15.3x	13.5x	13.0x	2.4	Bristol Myers	23.1	35.7x	29.7x	22.7x	19.1x	1.6
Biogen	9.4	17.7x	15.8x	14.6x	13.5x	2.2	JNJ	4.9	16.6x	15.9x	15.0x	14.4x	3.5
Celgene	22.8	23.4x	19.7x	15.5x	12.6x	1.3	Lilly	10.3	24.3x	22.9x	20.4x	18.1x	2.9
Gilead	4.6	8.9x	9.0x	8.5x	7.8x	2.9	Merck	6.6	15.2x	14.4x	13.9x	12.5x	2.3
Regeneron	17.4	44.8x	38.0x	30.6x	27.7x	3.2	Pfizer	10.8	15.0x	13.9x	12.3x	11.0x	1.3
Median	13.4	20.6x	17.8x	15.1x	13.2x	2.3	Median	10.6	15.9x	15.2x	14.5x	13.4x	2.0

Source: Bloomberg. Note: Forward PEG = 2014 P/E divided by 2015-18 consensus estimated EPS growth.

Fund profile: Specialist in quoted and unquoted biotech

IBT was launched in 1994 and has been managed by SV Life Sciences (initially as investment adviser until 2005) since 2001. SV Life Sciences (SVLS) is a specialist investor in quoted and unquoted healthcare companies, with access to 25 specialists and physicians in the investment team, and has recently won a specialist mandate to launch the Dementia Discovery Fund. IBT seeks capital growth by investing in high-growth biotech and healthcare companies, some of which may be at an early stage of development. The majority of assets (c 90%) are invested in a portfolio of quoted companies, managed by Carl Harald Janson, who joined SVLS and the trust in September 2013, and Ailsa Craig, a member of the team since 2006. The balance is invested in an unquoted portfolio managed by Kate Bingham, a managing partner of SVLS. In September 2014 IBT's board took the decision to pause investment in new unquoted holdings, although in the 2015 annual report they stated that as a result of the reduction in the risk profile of the quoted universe as companies mature, there may be a rationale for considering fresh unquoted investments over time.

The fund managers: Janson, Craig and Bingham

The managers' view: Pricing power and fundamentals intact

Janson and Craig are largely unconcerned by the scope for a politically motivated pricing debate to derail growth in the biotech market. While presidential hopeful Hillary Clinton's comments on 'price gouging' by the sector caused a wobble in late September, the managers believe that drug prices in

the US (by far the largest market for pharmaceuticals globally) will continue to be dictated by the market, rather than government, and that truly innovative companies (as later clarified by Clinton) will not be stifled by cost pressures. With fewer and bigger insurance companies negotiating harder on the treatments they are willing to reimburse, it is the best-in-class treatments targeting areas of unmet need that will have the greatest pricing power. The managers argue that such treatments actually reduce overall healthcare costs (of which drugs are only c 10% of the total) by avoiding or shortening hospital stays for many patients.

Blockbuster treatments with clear benefits, such as Gilead's hepatitis C 'cure' Sovaldi/Harvoni, have driven earnings growth for the biotech sector over recent years, and the managers see this as a trend that will continue, with year-on-year increases in the number of treatments in development. In addition, merger and acquisition activity has boosted the sector, with large-cap biotech companies joining the more established pharmaceutical companies among the ranks of the acquirers.

Biotech stocks have come a long way in recent years, but the managers feel fears of a bubble are overdone, particularly at the large-cap end. They point to a recent report by a US investment bank,¹ which compared valuations on biotech stocks and the wider US stock market since the nadir of the last bear market in March 2009; it found that while biotech had greatly outperformed the S&P 500, P/E valuations had expanded by less than for the index as a whole, suggesting the improvement was underpinned by earnings. New products were the main driver of increased revenues over the period, with margins also improving. However, the authors caution that in the pre-profitable sector of smaller biotech firms, there may have been an element of increased risk appetite from investors driving up prices, which could leave such companies more vulnerable to changing sentiment.

In the unquoted portfolio Bingham says the likely focus for any new investments would be at the more mature end of the market; the managers are looking at opportunities, but have not yet reached the point of investment.

Asset allocation

Investment process: Backing high-growth firms at all stages

IBT has been managed by SVLS – a specialist healthcare investor whose portfolio managers have a blend of life science and investment backgrounds – since 2001. Lead manager Carl Harald Janson joined in September 2013, having previously worked in the pharma and biotech industries, as well as managing funds including the Carnegie Biotechnology Fund.

Given its focus on both quoted and unquoted companies, IBT has two distinct investment approaches. For the quoted portfolio, Janson and co-manager Ailsa Craig seek to identify well-financed companies with experienced management teams, addressing areas of unmet medical need through strong intellectual property. Prospective investments should have a strong competitive position and be reasonably valued relative to peers. Companies with wholly owned assets are preferred to those that have partnered with other companies; Janson cites the example of ZS Pharma, whose wholly owned hyperkalemia treatment made it an acquisition target for AstraZeneca in early November, leading to an immediate 40% uplift in the share price.

The managers seek to reduce the binary risk of biotech investment by evaluating investments on a risk-adjusted basis, and may trade out of portfolio companies in advance of pivotal data releases. They also tend to eschew therapeutic areas where new treatments have historically seen a high rate of failure. The majority of assets are invested in companies that are already or are on the verge of becoming profitable, although a significant portion (40% of the trust at 31 October, including the unquoted holdings) is in earlier-stage companies that are yet to reach profitability.

¹ *Is There A Bubble In Biotech Stocks?* Cowen & Company, July 2015.

The unquoted portfolio, managed by Kate Bingham, includes many holdings that have been started or incubated by SVLS, a long-established venture capital investor in healthcare. In most cases SVLS has a seat on the board of its unquoted holdings, and retains close relationships with companies even after flotations or trade sales.

For both the quoted and unquoted portfolios, the managers meet frequently with companies and the team is represented at major healthcare industry conferences such as ASCO (the American Society of Clinical Oncology), which are often the venue for the release of new clinical developments.

The quoted portfolio managers decide on the implementation of gearing (a £35m overdraft facility means gearing of up to c 15% is possible given the current level of net assets), and are guided in part by market volatility: they monitor the VIX index of market volatility and are more likely to increase gearing when volatility is high and pare it back at lower levels.

Current portfolio positioning

At 31 October 2015 IBT's portfolio consisted of 96 holdings, of which 11 are unquoted (a further seven unquoted companies are no longer held, but are likely still to contribute to performance subject to the achievement of certain milestones). This is the longest stock list in the peer group, where the average number of holdings is 62. Reflecting the US-centric nature of the global biotechnology industry, 85% of the holdings at 31 October are based in the US and Canada, with the balance in the UK and Continental Europe. All of the top 10 quoted holdings are US companies, while more than half the companies in the unquoted portfolio are European.

A majority of portfolio holdings are focused on therapeutic areas such as immuno-oncology, rare diseases and viral or bacterial infections (Exhibit 3). Other areas of focus include medical devices, such as the stomach balloon developed by unquoted holding ReShape Medical and recently licensed by the FDA for the non-surgical treatment of obesity.

	Portfolio end August 2015	Portfolio end August 2014	Change
Therapeutics	83.5	79.4	4.1
Specialty pharmaceuticals	9.0	10.6	-1.6
Medical devices	4.3	4.0	0.3
Life science tools	3.2	6.0	-2.8
	100.0	100.0	

Source: International Biotechnology Trust, Edison Investment Research

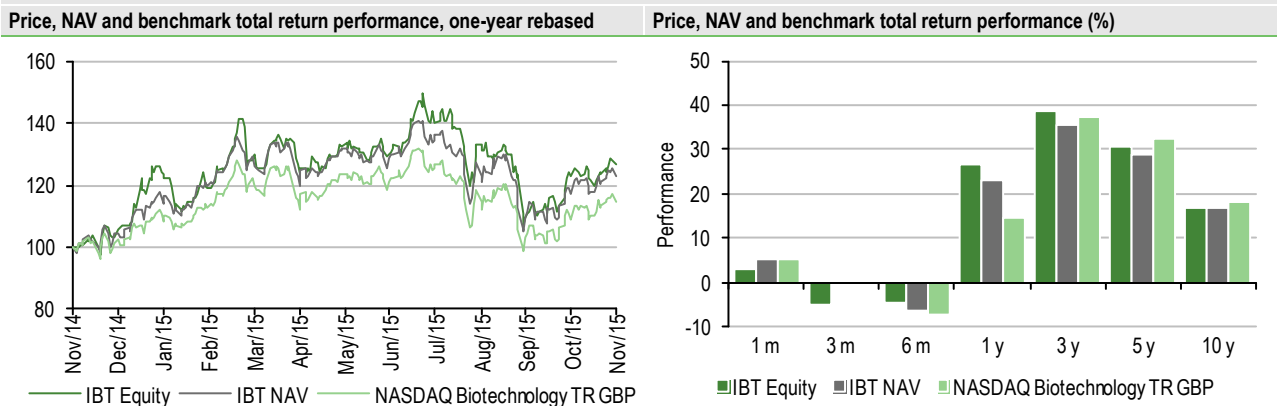
IBT's largest holdings include companies that the managers see as the bellwethers of the biotech sector, with good earnings growth, profitability and visibility of earnings. The four largest holdings at 31 October – Amgen, Celgene, Gilead and Regeneron – between them account for almost one-third of the total portfolio. These companies produced combined revenues of \$55bn in 2014 and made up four of the five biggest stocks in the NASDAQ Biotech Index at 31 October. (The biggest stock in the index, Biogen, is IBT's sixth-largest holding, below Ophthotech, a recent IPO that began as part of the unquoted portfolio.)

At the time of the late-August global market sell-off, the managers bought large-cap companies because they are liquid and easy to trade. However, as prices for small and mid-cap companies fell in September/October on the back of Hillary Clinton's comments on pricing, Janson says he took advantage of the more favourable valuations to top up holdings in these areas.

Highlights from the unquoted portfolio over FY15 included M&A activity, with Convergence Pharmaceuticals bought by Biogen (leading to a potential 9.2x return on IBT's initial investment), and Oncoethix sold to Merck. Entellus Medical, a US-based company whose sinus dilation device provides a minimally invasive treatment option for chronic sinusitis, floated on the US stock market in January.

Performance: Strong record under current manager

Exhibit 4: Investment trust performance to 30 November 2015



Source: Thomson Datastream, Edison Investment Research. Note: Three-, five- and 10-year performance figures annualised.

Exhibit 5: Share price and NAV total return performance, relative to indices (%)

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to NASDAQ Biotechnology	(2.1)	(4.8)	2.6	10.2	3.0	(5.2)	(10.2)
NAV relative to NASDAQ Biotechnology	(0.0)	0.2	0.6	7.3	(4.4)	(12.6)	(7.7)
Price relative to MSCI World Health Care	1.1	(5.9)	(0.5)	18.2	45.7	57.4	57.6
NAV relative to MSCI World Health Care	3.2	(1.0)	(2.4)	15.2	35.2	45.1	62.0
Price relative to FTSE All-Share	2.5	(7.1)	1.9	25.7	111.7	163.6	159.5
NAV relative to FTSE All-Share	4.7	(2.2)	(0.1)	22.4	96.5	143.0	166.7

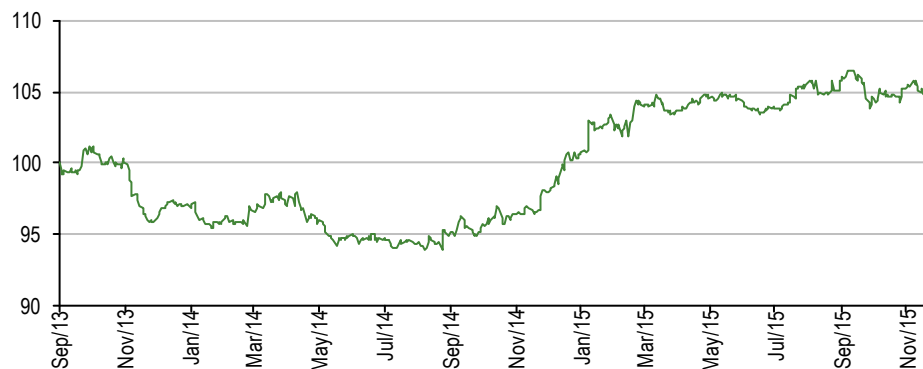
Source: Thomson Datastream, Edison Investment Research. Note: Data to end-November 2015. Geometric calculation.

IBT performed strongly over the 12 months to 30 November, beating the NASDAQ Biotech Index in both share price and NAV terms (Exhibits 4 and 5). Both trust and benchmark have seen a recovery from the sector sell-off in late September, sparked by Hillary Clinton's comments on 'price gouging'.

For the financial year ended 31 August 2015, the biggest gains came from Chimerix, Celgene, Incyte, Pharmacyclics (acquired during the year by AbbVie) and Regeneron, together adding £26.8m to IBT's NAV. The biggest detractors were Biogen, Intercept, Mylan, TransEnterix and VITAE Pharmaceuticals, between them reducing NAV by £6.1m. Unquoted investments contributed 29.9p or 15.7% of the 190.7p per share NAV increase for FY15, ahead of their 11.7% weighting at the year end. The managers note that buybacks also contributed to outperformance of the index.

Exhibit 6 shows IBT's NAV total return performance under lead manager Carl Harald Janson, who joined the trust in September 2013. IBT performed strongly relative to the benchmark in the second half of 2014 and has largely held on to those gains in the more difficult period since then.

Exhibit 6: NAV performance relative to benchmark under current manager



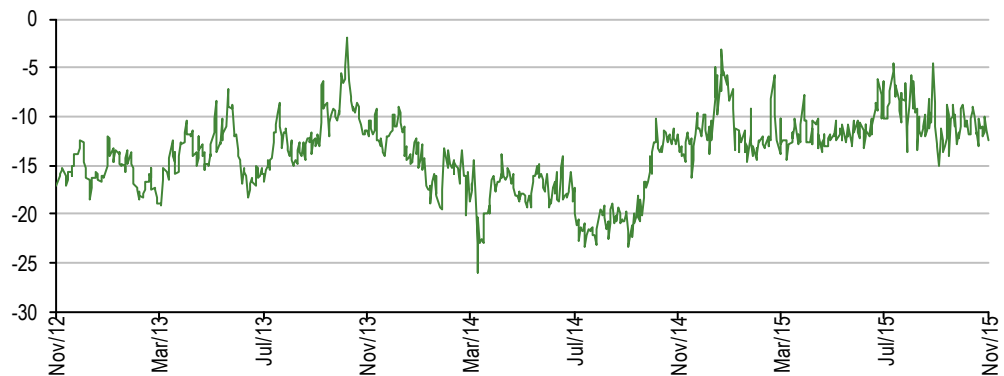
Source: Thomson Datastream, Edison Investment Research

Discount: Narrowing over 12 months

IBT's discount to cum-income NAV has seen an appreciable narrowing since October 2014, and stood at 11.6% at 10 December. This is in line with the one-year average discount of 10.9% and a little narrower than the three- and five-year averages (13.7% in both cases). In January 2015 the discount reached 3.2%, its narrowest point since November 2013, and any sustained improvement in the performance of biotech stocks would potentially prompt it to narrow again.

The board may buy back up to 14.99% or allot up to 5% of shares annually to manage a discount or premium. So far in 2015, 2.6m shares have been bought back at a cost of £13.0m.

Exhibit 7: Share price discount to NAV (including income) over three years (%)



Source: Thomson Datastream, Edison Investment Research

Capital structure and fees

IBT is a conventionally structured investment trust with one class of share. At 30 November there were 39.7m ordinary shares in issue, with a further 3.6m held in treasury. While it has an indefinite life, IBT is subject to a continuation vote every two years, with the next taking place at the 2017 AGM. The trust has a £35m overdraft facility to give it the flexibility to take advantage of investment opportunities. Gearing has tended to be modest and stood at 4.6% net at the 31 August year end.

SVLS receives an annual management fee of 0.9% of net assets, reduced from 1.15% with effect from 1 March 2015. Performance fees may also be paid in respect of both quoted and unquoted portfolio performance. For the quoted portfolio, a performance fee of 10% is payable on outperformance of more than 0.5% versus the sterling-adjusted NASDAQ Biotech Index, while the unquoted portfolio may receive a performance fee of 20% of net realised gains. In both cases there is a high water mark, which is revised upwards each time a performance fee is paid. For the year ended 31 August 2015, both portfolios met the conditions for payment of a performance fee, which amounted to £1,348,000. Ongoing charges for FY15 (excluding performance fees) were 1.5%.

Dividend policy and record

IBT's focus on fast-growing companies at an early stage of development means its holdings typically do not pay dividends; many of the holdings are not yet profitable, and those that are will generally reinvest their income for future growth. Because of this, IBT's revenues are modest and are more than offset by expenses charged to income, such as the management fee. IBT's investment objective is to achieve capital growth; it has not paid a dividend since 2002 and does not expect to do so in the foreseeable future.

Peer group comparison

IBT is one of four UK-listed investment trusts specialising in biotech and healthcare; Exhibit 8 below also includes BB Biotech, listed in Switzerland. Within the peer group are three biotech specialists and two trusts with a broader healthcare focus. Strong recent performance has seen IBT rise to the top of the peer group for NAV total return over one year; over three and five years it ranks third. Risk-adjusted performance as measured by the Sharpe ratio is in line with peer group averages over one and three years. In common with its UK-listed biotech peers, IBT does not pay dividends (BB Biotech's 'dividend' is a capital distribution). Ongoing charges are the highest in the group (partly because IBT's smaller size means fixed costs have a greater impact in percentage terms) but are yet to reflect fully a reduction in the management fee with effect from 1 March 2015. IBT's gearing is above the sector weighted average, while its discount is the second widest in the group.

Exhibit 8: Biotech and healthcare investment companies as at 7 December 2015

% unless stated	Market Cap £m	NAV TR 1 Year	NAV TR 3 Year	NAV TR 5 Year	Ongoing Charge	Perf. fee	Discount (ex-par)	Net Gearing	Dividend yield (%)	Sharpe 1y (NAV)	Sharpe 3y (NAV)
International Biotechnology Trust	210.0	16.2	146.9	244.5	1.5	Yes	-10.1	100.0	0.0	0.9	1.5
BB Biotech AG	2285.1	12.5	216.8	354.9	1.1	No	-18.8	100.0	4.9	0.9	1.7
Biotech Growth Trust	432.4	6.4	156.2	342.9	1.2	Yes	-9.2	113.0	0.0	0.5	1.4
Polar Capital Gbl Healthcare	210.5	2.8	59.0	110.6	1.1	Yes	-3.3	100.0	2.1	0.3	1.4
Worldwide Healthcare	882.5	10.6	125.3	189.8	1.0	Yes	-5.7	113.0	0.7	0.7	1.8
Sector weighted average		11.1	178.3	298.8	1.1		-13.6	104.3	3.6	0.8	1.7
IBT rank in sector	5	1	3	3	1		4	3	4	1	3

Source: Morningstar, Edison Investment Research. Note: TR=total return. Sharpe ratio is a measure of risk-adjusted return. The ratios shown are calculated by Morningstar for the past 12- and 36-month periods by dividing a fund's annualised excess returns over the risk-free rate by its annualised standard deviation. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared). BB Biotech is listed in Switzerland and is not part of the AIC peer group. All performance data are in sterling terms.

The board

IBT's five non-executive directors provide a blend of life sciences and investment management expertise. Alan Clifton, the chairman since 2012, joined the board in 2001. He is a former managing director of Morley Fund Management. Dr Véronique Bouchet, a life sciences consultant, became a director in 2009, while John Aston, former chief financial officer of Cambridge Antibody Technology, was appointed in 2011. In 2013 Jim Horsburgh, a former fund manager and ex-chief executive of Witan Investment Trust joined the board, while the newest director, chartered accountant Caroline Gulliver, was appointed in April 2015. Dr David Clough retired from the board at the 2015 AGM.

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