EDISON

International Biotechnology Trust

Selecting for growth in a growth sector

Investment trusts

Now in its 21st year, International Biotechnology Trust (IBT) is a specialist investor in biotechnology companies globally. In the year to end February 2015, it returned c 50% in NAV and 49% in share price terms, ahead of the Nasdaq Biotechnology Index's 39% return. IBT is differentiated from its peers by its holdings in unquoted stocks (c 8% at present), a part of the portfolio that has recently contributed to the trust's strong performance, reflecting successful exits and a milestone payment. The long-term growth drivers for the biotech sector remain in place and the managers expect strong sector earnings growth to outpace market growth over the long term.

12 months ending	Share price (%)	NAV (%)	NASBIOT Index (%)	MSCI World Healthcare (%)	FTSE All-Share Index (%)
29/02/12	23.9	24.1	28.4	12.7	1.5
28/02/13	18.3	23.6	31.4	29.1	14.1
28/02/14	52.8	49.2	62.9	23.5	13.3
28/02/15	49.7	49.4	38.7	27.7	5.6

Source: Thomson Datastream. Note: Total return basis.

Investment strategy: Focus on growth, novel drugs

IBT invests in a diversified portfolio of biotech companies from mature earnings-driven companies to earlier-stage private companies. From Q414 investments in new unquoted companies have been halted in favour of quoted investments where the managers see opportunities for continued strong performance. Lead manager, Carl Harald Janson, appointed in September 2013, applies a stock selection process that focuses on well-financed companies with experienced management, strong intellectual property, products addressing areas of high medical need, possessing pricing power and trading at a reasonable valuation. The managers seek to reduce risk by limiting exposure to high-risk therapeutic areas and binary events; they are also able to draw on the extensive experience of their colleagues in the 30-strong SV Life Sciences investment team.

Market outlook: Above-average secular growth

The long-term reasons for optimism on the prospects for the biotechnology sector remain in place; acceleration of innovation in the industry itself combined with rising demand from ageing populations and increasingly wealthy emerging markets. There are risks to monitor, including pricing pressures. The sector has also experienced sharp corrections in the past but has subsequently resumed its ascent. P/E valuations for biotech stocks relative to growth appear moderate compared with top pharmaceuticals. The prospect of further partnerships and M&A in the sector seems likely to help underpin valuations and could provide profitable exits for some of IBT's unquoted and smaller cap holdings.

Valuation: Discount could contract further

The current discount of 13.2% is narrower than the 15-20% seen following the correction last year but is above some of its peers. Value-additive transactions in the unquoted segment and a continued reduction in exposure to this area could prompt a further narrowing in the discount.

3 March 2015

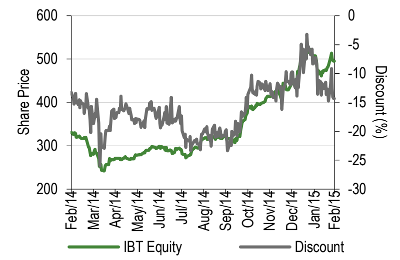
Price	**495p**
Market cap	**£207m**
AUM	**£238m**

NAV*	574.24p
Discount to NAV	13.8%
NAV**	570.06p
Discount to NAV	13.2%
Yield	0.0%

*Excl. income. **Incl. income. Data at 27 February 2015.

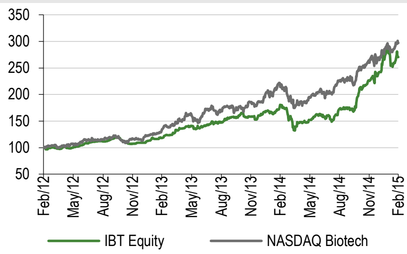
Ordinary shares in issue	41.8m
Code	IBT
Primary exchange	LSE
AIC sector	SS: Biotech/Healthcare

Share price/discount performance*



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

Three-year cumulative perf. graph



52-week high/low	524.25p	242.00p
NAV* high/low	577.65p	312.56p

*Excluding income.

Gearing

Gross	5.0%
Net	5.0%

(At year end: 31 August 2014)

Analysts

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Edison profile page

International Biotechnology Trust is a research client of Edison Investment Research Limited

Exhibit 1: Trust at a glance

Investment objective and fund background

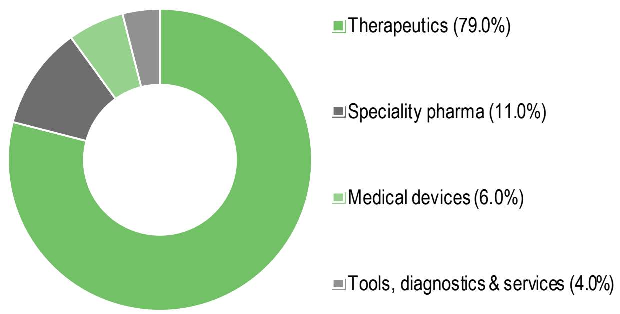
International Biotechnology Trust (IBT) aims to achieve long-term capital growth by investing in biotechnology and other life sciences companies, both quoted and unquoted, that have high growth potential. IBT invests in companies considered to have good prospects, experienced management and strong upside 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

- 12 January 2015: Biogen Idec agrees to buy unquoted portfolio company, Convergence. Consequent NAV uplift 9.4p.
- 18 December 2014: Merck acquired unquoted portfolio company, OncoEthix and a milestone payment, related to the sale of ESBATech, received in Jan 2015. NAV uplift from both 5.7p.

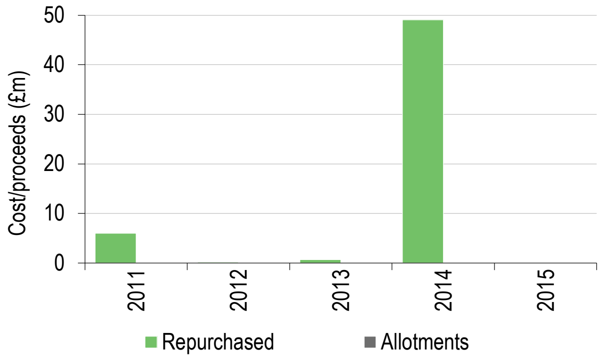
Forthcoming		Capital structure		Fund details	
AGM	December 2015	Ongoing charges	1.70%	Group	SV Life Sciences Managers
Interim results	April 2015	Net gearing	5.0% (Aug 2014)	Manager	Carl Harald Janson, Ailsa Craig, Kate Bingham
Year end	31 August	Annual mgmt fee	1.15% of net assets (0.9% from Mar 2015)	Address	71 Kingsway, London, WC2B 6ST, UK
Dividend paid	N/A	Performance fee	See page 7		
Launch date	May 1994	Trust life	Indefinite	Phone	+44 (0)20 7421 7070
Continuation Vote	Two-yearly, next 2015	Loan facilities	£30m overdraft facility	Website	www.ibtplc.com

Sector distribution as at 31 August 2014

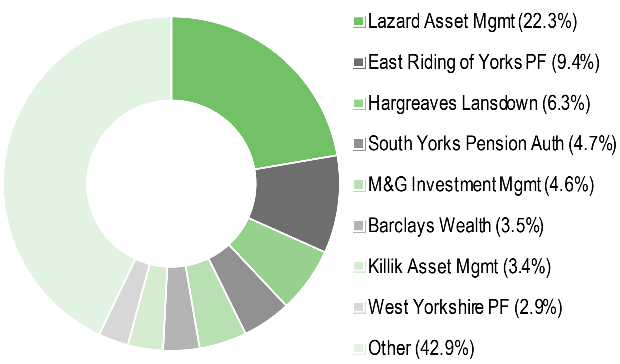


Share buyback policy and history

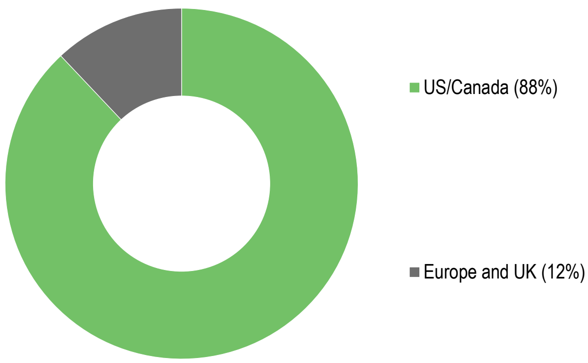
Renewed annually, the trust has authority to purchase up to 14.99%, and allot up to 5.0% of issued share capital.



Shareholder base (as at 31 December 2014)



Geographic distribution of portfolio (as at 31 January 2015)



Top 10 holdings (as at 31 January 2014)

Company	Country	Main focus	Portfolio weight %	
			31 January 2015	31 January 2014*
Celgene	US	Oncology/inflammatory diseases	7.1	5.2
Gilead	US	Infectious diseases	7.1	7.6
Biogen Idec	US	Oncology/inflammatory diseases	6.7	6.8
Amgen	US	Oncology/autoimmune diseases	5.2	4.8
Chimerix	US	Antivirals	4.9	N/A
Alexion Pharmaceuticals	US	Orphan diseases	3.3	4.1
Vertex Pharmaceuticals	US	Orphan/infectious diseases	3.1	3.5
Pharmacyclics	US	Oncology	3.0	N/A
Ophthotech	US	Ophthalmic disorders	2.9	N/A
Regeneron	US	Ophthalmic disorders	2.7	5.5
			46.0	**47.0**

Source: International Biotechnology Trust, Edison Investment Research, Morningstar, Bloomberg. Note: *N/A where not in top 10 at 31 January 2014.

Sector outlook: Growth and valuation in its favour

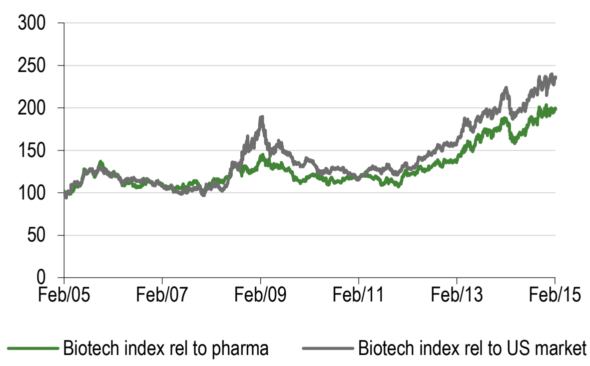
Last year the biotechnology sector suffered a significant correction in March/April, reflecting a combination of profit-taking and reaction to criticism of the pricing of Gilead's blockbuster hepatitis C drug, Sovaldi/Harvoni. This is evident in the relative performance chart on the left in Exhibit 2. What is clearer, however, is that this proved to be merely a blip in the upward march of the biotechnology sector relative both to the wider market (here represented by the Datastream US market index) and the pharmaceutical sector index.

Market values have risen as the industry matured from the stage when biotechnology companies were small pioneers of new techniques within healthcare and most were unprofitable. The leading companies are now substantial and profitable (sector leader Gilead has a market cap of over $100bn and forecast revenues of nearly $30bn) but innovation has if anything accelerated, as measured by novel drug approvals, and the pipeline of new products suggests there is potential for further significant revenue and profit growth.

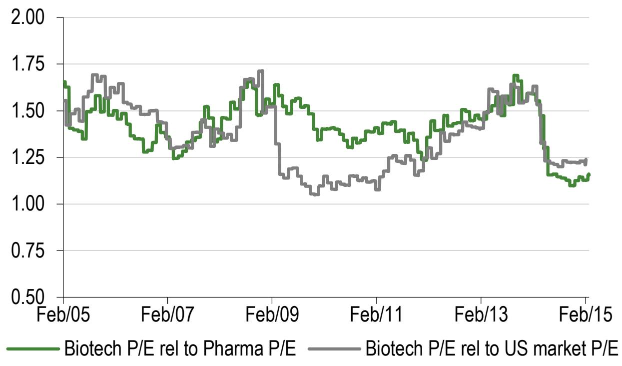
For investors, the prospect of further exciting developments within this industry could be unrewarding if already reflected in share prices but, as the second chart in Exhibit 2 illustrates, the biotech sector's forward P/Es, relative to the broad pharmaceutical sector and the US market, are noticeably below historical levels. P/E to growth (PEG) ratios are also relatively attractive (see Exhibit 3). Naturally there are risks: there is continuing debate about the prospects for product pricing in the US while individual stocks can be highly volatile around key data points on new products. These risks highlight the merits of gaining exposure to this market sector through an actively managed fund that seeks to monitor and mitigate such exposures.

Exhibit 2: Healthcare sector performance and valuation comparisons

World-DS Biotech versus pharma and US-market indices



World-DS Biotechnology P/E relative to pharma and US-market P/Es



Source: Thomson Datastream, Edison Investment Research. Note: Data at 6 February 2015. Uses Datastream indices.

Fund profile: Differentiated by public/private portfolio

Launched in 1994, IBT has been managed since 2001 (officially as investment adviser until 2005) by SV Life Sciences (SVLS), an established specialist in the healthcare sector. The trust seeks to achieve capital appreciation by investing in high-growth biotechnology and other life sciences companies that can be either quoted or unquoted. The quoted portfolio is managed by Carl Harald Janson and Ailsa Craig. Janson joined as lead manager on the quoted portfolio in September 2013 while Craig has been on the IBT management team since 2006. The unquoted component of the portfolio, managed by Kate Bingham, is a differentiating feature for IBT but new private investments have been paused from September 2014, reflecting the potential the managers see for continued strong returns in listed equities. The current unquoted weighting is therefore set to fall from the end-January level of 8%. Prior to 2011 the trust used an absolute performance measure, but since then has had the NASDAQ Biotech Index as its benchmark. IBT invests globally but is heavily weighted towards the US, where the majority of biotech companies are listed.

Fund managers: Janson, Craig and Bingham

Managers' view: Scope to move up a PEG

Far from being in overstretched territory, the managers see the biotechnology sector as being in a long-term upcycle. Janson points to the great advances that have been made in the last decade in understanding the functioning of a healthy human body and the variations in molecular and cellular biology that lead to disease. However, he says "we are still only scratching the surface" and believes the future holds a string of further advances in treatments and hence new investment opportunities. Whole new therapeutic classes of molecules/techniques including antisense/siRNA, gene therapy and cell therapy have the potential to open up completely new markets.

Other positive features the managers identify in the biotech area include the use of biomarkers to increase the precision of drug therapy and an improving regulatory environment that is facilitating the development of successful drugs. Further, demand from ageing populations and more prosperous emerging markets should ensure innovative drugs find a ready market. The growth in the sector means the managers are able to balance investment in substantial profitable, cash generative companies and smaller early-stage businesses as well as between therapeutic areas to reflect their judgement on relative risks/rewards.

On pricing, where there has recently been pressure in the US on drug reimbursement, exemplified by Gilead's Harvoni, the managers comment that, ironically, the efficacy of this treatment may have prompted resistance from pharmacy benefit managers as a cure could, over time, remove a large patient group. Janson has a sanguine view on the long-term prospects for pricing given the potential to develop new ways to accommodate payment for drugs in development that could potentially cure diseases like haemophilia in a single treatment (gene therapy).

Crucially the managers regard the sector as still reasonably valued. Exhibit 3 compares the valuations of the top biotech and pharmaceutical companies. The combination of starting valuation and consensus growth expectations puts the biotech companies on a median PEG of 1.6x versus 1.9x for the pharmaceuticals companies.

Exhibit 3: Large-cap biotech and pharma historical and estimated P/E multiples (at 27 February 2015)

Top biotech	2015-18 EPS CAGR (%)	Hist P/E	2015 P/E	2016 P/E	2017 P/E	Forward PEG	Top pharma	2015-18 EPS CAGR (%)	Hist P/E	2015 P/E	2016 P/E	2017 P/E	Forward PEG
Alexion	21.6	34.9x	31.0x	25.0x	20.5x	1.6	Abbvie	10.1	18.3x	13.8x	12.1x	11.1x	1.8
Amgen	11.9	18.1x	16.9x	15.0x	13.0x	1.5	Bristol Myers	25.6	33.0x	36.1x	27.7x	21.9x	1.3
Biogen-IDEC	15.0	29.4x	23.9x	20.4x	17.9x	2.0	JNJ	5.9	17.2x	16.6x	15.8x	14.8x	2.9
Celgene	24.8	33.0x	25.4x	19.6x	15.6x	1.3	Lilly	12.0	25.2x	22.3x	19.5x	17.8x	2.1
Gilead	7.8	12.8x	10.9x	10.0x	9.3x	1.6	Merck	8.3	16.8x	17.3x	15.4x	14.9x	2.0
Regeneron	19.0	41.7x	39.0x	33.8x	26.7x	2.2	Pfizer	10.1	15.3x	16.6x	15.5x	14.1x	1.5
Median	**17.0**	**31.2x**	**24.7x**	**20.0x**	**16.8x**	**1.6**	**Median**	**10.1**	**17.7x**	**17.0x**	**15.6x**	**14.8x**	**1.9**

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

Asset allocation

Investment process: Seeking opportunities across the sector

SV Life Sciences has managed IBT since 2001 with a change in the team in 2013 when Carl Harald Janson joined to manage the quoted part of the portfolio. As well as six years of operational experience in the pharmaceutical/biotech industry, he has 11 years' experience of investing in healthcare and managed the Carnegie Biotechnology Fund between 2000 and 2007, during which time it was the top-performing biotechnology fund out of c 40 peers globally. Janson describes the investment process for IBT as involving stock selection, portfolio construction and a decision on leverage. Stock selection focuses on well-financed companies with experienced management, strong intellectual property, addressing high medical needs, with pricing power and trading at a reasonable valuation. The managers seek to reduce risk by, for example, limiting investments in therapeutic areas that have historically had a high failure rate and by avoiding exposure to investments that are approaching an event that will have a binary outcome with a potentially significant downside risk. The portfolio is constructed with a balance between profitable larger cap companies, mid caps with revenues, and earlier stage small caps and unquoted companies. Most of the portfolio is invested in therapeutic companies and a minority (sub-5% currently) in companies supplying tools, diagnostics and services. IBT's debt facility (currently £30m) is used tactically to take advantage of market fluctuations.

In the unquoted portfolio, many holdings have been started or incubated by SVLS, reflecting the manager's resources and well-established position in this area. In both the quoted and unquoted portfolios, SVLS's approach is to have close links with the companies it invests in (to the extent of having a board seat on most of the unquoted companies held). The managers of the quoted portfolio often meet with company managements, either at SVLS's base in London or during frequent visits to the US, where they also often attend industry conferences.

Current portfolio positioning and recent activity

At the end of January, IBT had 83 investments, including unquoted holdings. Of the whole portfolio, 52% of holdings were profitable, 43% unprofitable and 5% turning profitable in 2015. In the unquoted portfolio, 8% of companies were pre-clinical, 55% clinical (ie advanced trial stage), 24% revenue generating but pre-profit, and 13% profitable (at 31 August).

As noted, fresh unquoted investments have been paused since the August year end and the January portfolio weighting was 8% compared with 12% a year earlier, reflecting a number of exits (five trade sales since January 2014) and limited new or follow-on investments. Three unquoted companies (Celerion, Oncoethix and Convergence) were sold in the five months to end January generating gains of £7.4m on a cost of £1.6m (realising 5.6x cost). A further potential £7.2m earn out is possible but not yet recognised in the NAV. In addition, medical device company Entellus had a successful public offering on Nasdaq (current value 2.3x cost). Since inception, a multiple of 2.1x has been achieved on all fully and partly exited and listed holdings. While the normal risks associated with small unquoted companies apply, the favourable market environment suggests reasonable prospects for further significant gains.

In the quoted portfolio, the top 10 stocks account for 46% of the fund with holdings skewed towards firms seen as having good earnings growth and robust business models. Talking about changes in the portfolio, Janson and Craig highlight that they have reduced the specialty pharmaceuticals segment in favour of the core biotech holdings and have added to small cap positions. They see companies with antibiotics products as attractive both because of underlying demand and because of valuation in what had been a less-favoured sub-sector. Merck's acquisition of Cubist has been a positive catalyst and the managers see further upside for holdings in Cempra and Tetraphase.

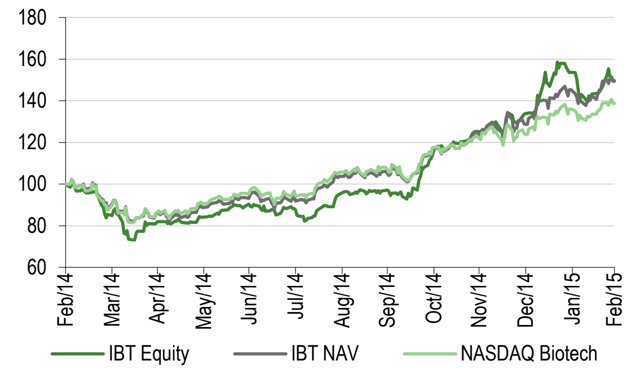
Performance: Strong absolute performance record

IBT has a strong long-term history of absolute returns: annualised NAV total returns were c 49%, 40% and 28% over one, three and five years and nearly 17% over 10 years (see Exhibit 4). Before September 2011 the quoted portfolio performance was measured against an absolute hurdle rate of 7% with the Nasdaq Biotech Index adopted as the benchmark since then. From 1 September 2011 to end January 2015, IBT's ex-income NAV return was 230.9%[1] with the quoted part of the portfolio returning 277.3%[2] and the benchmark 268.9%[1]. Since the appointment of the current lead manager (September 2013) IBT's ex-income NAV return has been 76.7%[2] versus 71.9%[1] for the benchmark. (Sources: 1 Bloomberg; 2 SVLS)

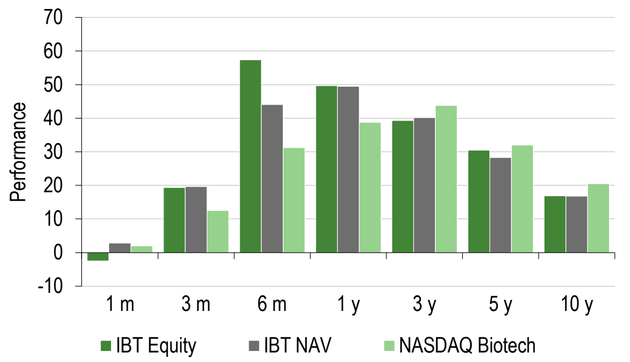
Exhibit 6 highlights a marked strengthening of NAV relative performance since mid-2014 with contributors to this being: (1) large overweight positions in a number of smaller cap names; (2) significant underweights in both the specialty pharmaceuticals and the tools, diagnostics & services sectors; (3) gains on the unquoted portfolio (c 3% absolute contribution from the realisations and milestone payments announced in December and January); and (4) the accretive effect of share buybacks (c 3% from September to January).

Exhibit 4: Investment trust performance to 27 February 2015

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



Price, NAV and benchmark* total return performance (%)*



Source: International Biotechnology Trust, Thomson Datastream, Edison Investment Research. Note: *Three, five and 10 years annualised. Reflecting a change in its performance fee structure, IBT's quoted portfolio has been benchmarked against the NASBIOT from 2011. Prior to 2011, the quoted portfolio had an absolute return goal.

Exhibit 5: Share price and NAV total return performance, relative to benchmarks (%), to 27 February 2015

	One month	Three months	Six months	One year	Three years*	Five years*	10 years*
Price relative to NASDAQ Biotech	(4.5)	6.0	19.9	7.9	(8.9)	(5.6)	(26.4)
NAV relative to NASDAQ Biotech	0.8	6.3	9.7	7.7	(7.2)	(13.3)	(26.8)
Price relative to MSCI World Health Care	(4.1)	12.9	32.2	17.2	32.8	63.1	35.6
NAV relative to MSCI World Health Care	1.2	13.2	21.0	17.0	35.3	49.9	34.9
Price relative to FTSE All Share	(6.1)	13.9	51.2	41.8	98.3	133.2	122.8
NAV relative to FTSE All Share	(0.9)	14.2	38.4	41.6	102.0	114.3	121.7

Source: IBT, Thomson Datastream, Edison Investment Research. Note: *See note in Exhibit 4. Geometric calculation.

Exhibit 6: IBT NAV total return vs NASBIOT total return over three years, rebased to 100

Source: International Biotechnology Trust, Thomson Datastream, Bloomberg, Edison Investment Research

Discount: Aiming to maintain a lower level

In the first three quarters of 2014, IBT's discount to NAV was mostly in the high teens and above, with a spike when major shareholder Astra Zeneca sold and later adverse sentiment accompanying the sector correction in April and May contributory factors. Subsequently there has been a sharp narrowing as the sector rallied, IBT's own relative performance saw a sustained improvement and substantial share buybacks were implemented to provide liquidity in the market (c 20% of the outstanding number of shares). At the AGM the board made clear that it aims firstly, to reduce volatility in the discount and secondly, is minded to aim for a lower level than had been seen earlier in the year, potentially at or below the 10-12% range.

Exhibit 7: Discount over three years, including income

Source: Thomson Datastream, Edison Investment Research. Note: Negative values indicate a discount.

Capital structure and fees

IBT has one class of share, with 41.8m shares in issue (as at 27 February) and a further 3m held in treasury. The trust may buy back shares up to 14.99% and allot shares up to 5% each year. IBT has an indefinite life but is subject to two-yearly continuation votes; the next is due at the 2015 AGM.

IBT has a £30m overdraft facility; the board intends that this should be used on a relatively short-term basis to take advantage of investment opportunities. As noted earlier, the managers do not expect to employ a high level of gearing and currently this is in the range of 0-5%.

IBT's manager, SV Life Sciences, receives a management fee of 0.9% of NAV, reduced on 1 March from 1.15%. In addition, performance fees may be paid subject to certain hurdles. For the quoted portfolio (c 90% of assets), a performance fee of 10% is payable on outperformance of the sterling-adjusted NASDAQ Biotech Index + 0.5%. For the unquoted portfolio, a performance fee of 20% of net realised gains may be paid. Both fees are subject to a high-water mark, initially set in August 2011 and revised upwards whenever a performance fee is paid. No performance fee is paid unless the NAV exceeds this mark; in addition, the payment of such a fee may not cause the NAV to drop below the NAV on the first day of the relevant period. The performance fee is capped at 3% of average net assets during the year, although any excess may be held over and added to future performance fees, subject to the same conditions. No performance fee was paid for the last three financial years; ongoing charges for FY14 were 1.7%.

Dividend policy: Growth is the priority

The biotechnology companies in which IBT invests are usually at a stage of development where profits are reinvested for future growth in the business rather than paid out as dividends. For the financial year to end-August 2014, as in the previous year, income received was therefore more than offset by expenses charged to income. IBT's policy is not to pay dividends, and the last time a dividend was paid was in 2002.

Peer group comparison

The peer group shown in Exhibit 8 includes three biotech-focused companies (IBT itself, Biotech Growth and Swiss-listed BB Biotech) and two broader healthcare funds. IBT is the smallest fund in this closed-ended peer group. In terms of net asset value total return it ranks second over one year and third over three and five years. Risk-adjusted performance as measured by the Sharpe ratio is above average over one year and similar to the average over three years. There is a wide range of discounts in the peer group and although now trading at a lower discount than BB Biotech, IBT's discount is still significantly wider than the other companies. The biotech-focused companies are all shown as having a zero dividend, although this excludes the payment made under the capital distribution policy followed by BB Biotech.

Exhibit 8: Biotech and healthcare investment companies

Percentage unless stated	Market cap £m	TR one year	TR three years	TR five years	Ongoing charges (%)	Perf. Fee	Discount (-) /premium	Net gearing	Yield	Sharpe NAV one year	Sharpe NAV three years
International Biotechnology Trust	**208.2**	**47.0**	**176.1**	**255.6**	**1.7**	**Yes**	**(13.5)**	**105.0**	**0.0**	**1.9**	**2.0**
BB Biotech AG	2561.4	51.8	287.8	336.3	0.8	No	(16.3)	102.0	0.0	1.4	2.0
Biotech Growth Trust (The)	475.2	35.4	220.9	356.9	1.2	Yes	(4.3)	106.0	0.0	1.6	2.2
Polar Capital Global Healthcare	203.9	18.9	79.3		1.1	Yes	(9.3)	96.0	2.1	2.1	2.1
Worldwide Healthcare Trust	901.5	34.3	141.3	190.0	1.0	Yes	(0.5)	112.0	0.8	2.4	2.3
Sector weighted average		**44.6**	**235.0**	**302.8**	**1.0**		**(11.2)**	**104.4**	**1.0**	**1.7**	**2.1**
IBT rank in sector	**4**	**2**	**3**	**3**	**1**		**4**	**3**	**3**	**3**	**4**

Source: Morningstar, 27 February 2015, Edison Investment Research. Notes: TR = NAV total return. The Sharpe ratio is a measure of risk-adjusted return. The ratios we show 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 shown here as total assets less cash/cash equivalents as a percentage of shareholders' funds (100=ungeared). BB Biotech is Switzerland-listed and not part of the AIC peer group. All performance data is in sterling terms.

The board

IBT has five non-executive directors. Alan Clifton (former MD of Morley Fund Management) joined the board in 2001 and has been chairman since 2012. Dr David Clough (a former director of research at Roche) became a director in 2004. Life sciences specialist Dr Véronique Bouchet joined the board in 2009, while John Aston (a former CFO of Cambridge Antibody Technology and Astex Therapeutics) was appointed in 2011. The newest board member, Jim Horsburgh (whose investment management roles included a period as CEO of Witan Investment Trust), became a director in February 2013.

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