

# International Biotechnology Trust

## A new manager for the quoted portfolio

International Biotechnology Trust (IBT) provides investors with exposure to the fast-growing biotechnology market through both quoted (86%) and unquoted investments (14%). Secular drivers, include ageing populations, increasing demand in emerging markets and acceleration in new product development, are encouraging. Sector valuations have expanded but, in the manager's view, are still reasonable with median large-cap biotech estimated PEG ratio standing at c 1.2x.

12 months ending	Total share price return* (%)	Total NAV return* (%)	Total return NASBIOT Index* (%)	Total return MSCI World Healthcare* (%)	Total return FTSE All-Share* (%)
30/11/10	13.7	11.7	16.2	5.5	11.5
30/11/11	10.2	5.7	16.4	11.0	2.6
30/11/12	30.0	34.6	34.1	19.5	12.1
30/11/13	47.5	38.2	58.9	33.3	19.8

Note: \*Twelve-month rolling discrete performance.

### Investment strategy: Development-stage biotech

IBT invests in development-stage biotechnology companies and maintains a quoted portfolio (40-50 stocks) and an unquoted portfolio (20-25 stocks). The investment process employs extensive fundamental research with investments held for the longer term. Positions are actively monitored, particularly for trial events with a binary outcome. IBT can borrow on a short-term basis and debt is unlikely to exceed 10% of the quoted NAV. IBT does not have any structural gearing.

### 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, in the manager's view, the conjunction of strong growth prospects across both the large-cap stocks and less mature stocks is set to narrow the gap in valuation with top pharma stocks over the next three years. PEG ratios are at attractive levels.

### Valuation: Discount below longer-term averages

The cum-income discount, currently at 13.4%, is below its three- and five-year averages of 13.5% and 15.4% respectively. The discount reached a five-year low in June 2013, immediately prior to the announcement of David Pinniger's departure from SV Life Sciences (SVLS). The discount subsequently expanded to c 19%, but tightened significantly reaching a new five-year low of 1.8% at the beginning of November.

## Investment trusts

20 December 2013

**Price** 280.75p  
**Market cap** £155m  
**AUM** £180m

NAV\* 325.68p  
Discount to NAV 13.8%  
NAV\*\* 324.22p  
Discount to NAV 13.4%  
Yield 0.0%

\*Adjusted for debt at par value and excluding income, as at 18 December 2013. \*\*Adjusted for debt at market value and including income, as at 13 December 2013.

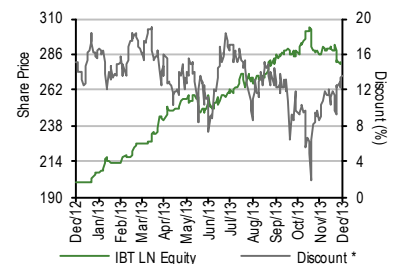
Ordinary shares in issue 55.2m

Code IBT

Primary exchange LSE

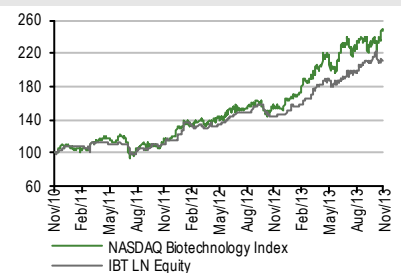
AIC sector SS: Biotech/Life sciences

### Share price/discount performance



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

### Three-year cumulative perf. graph



52-week high/low 304.50p 200.00p

NAV\* high/low 332.21p 228.41p

\*Adjusted for debt at market value, including income.

### Gearing

Gross 0.0%

Net 0.0%

### Analysts

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[Edison profile page](#)

### Exhibit 1: Trust at a glance

#### Investment objective and fund background

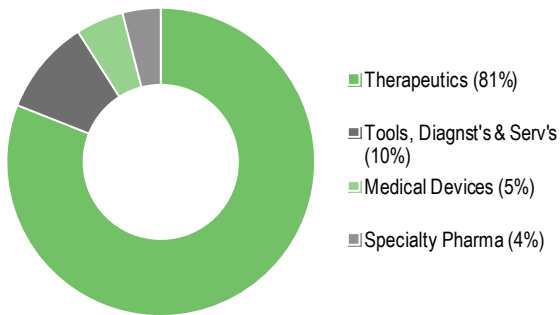
IBT aims to achieve long-term capital growth by investing in development-stage biotechnology and other life sciences companies, both quoted and unquoted, that have high growth potential. IBT invests in companies considered to have good prospects, experienced management and strong upside potential through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

18 December 2013: AGM – all resolutions passed.  
 28 October 2013: Annual report for the year ended 31 August 2013 released.  
 2 September 2013: SV Life sciences appointed Carl Harald Janson as investment manager of IBT's quoted portfolio.

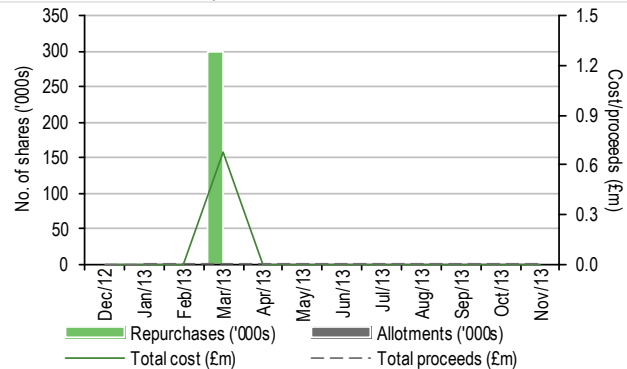
Forthcoming		Capital structure		Fund details	
AGM	December 2014	Ongoing charges	1.70%	Group	SV Life Sciences Managers
Interim results	April 2014	Net gearing	0.0%	Manager	Carl Harald Janson, Kate Bingham, Ailsa Craig
Year end	31 August	Annual mgmt fee	1.15% of net assets	Address	71 Kingsway, London, WC2B 6ST, UK
Dividend paid	N/A	Performance fee	See page 7	Phone	+44 (0)20 7421 7070
Launch date	May 1994	Trust life	Indefinite	Website	<a href="http://www.ibtplc.com">www.ibtplc.com</a>
Continuation Vote	Vote every two years	Loan facilities	£15m overdraft facility		

#### Sectoral distribution as at 31 August 2013

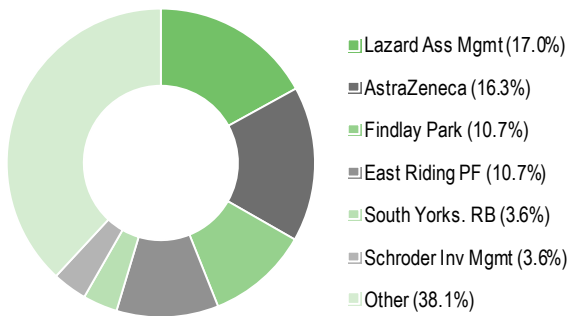


#### Share buyback policy and history

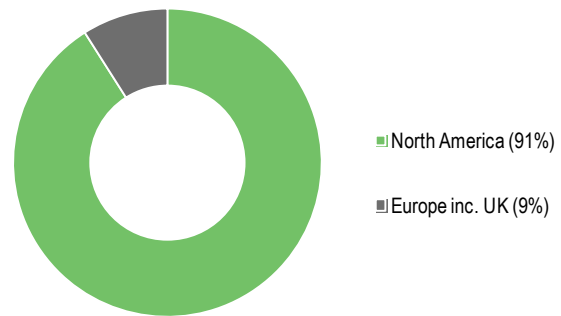
Renewed annually, the trust has authority to purchase up to 14.99%, and allot up to 5.0% of issued share capital.



#### Shareholder base (as at 20 November 2013)



#### Geographic distribution of portfolio (as at 31 October 2013)\*



#### Top 10 holdings (as at 30 November 2013)

Company	Country	Sector	Portfolio weight %	
			30 November 2013	31 May 2013
Biogen Idec	US	Biotech & Pharma/Therapeutics	8.5	3.9
Celgene	US	Biotech & Pharma/Therapeutics	8.2	6.1
Gilead Sciences	US	Biotech & Pharma/Therapeutics	7.9	6.9
Amgen	US	Biotech & Pharma/Therapeutics	6.5	6.6
Regeneron Pharmaceuticals	US	Biotech & Pharma/Therapeutics	5.9	2.7
Alexion Pharmaceuticals	US	Biotech & Pharma/Therapeutics	4.0	5.0
Mylan	US	Biotech & Pharma/Therapeutics	3.8	2.0
Incyte	US	Biotech & Pharma/Therapeutics	3.7	1.9
Aptiv Solutions (Unquoted)	US	Biotech & Pharma/Research Services	3.0	3.6
Vertex Pharmaceuticals	US	Biotech & Pharma/Therapeutics	2.7	2.1
<b>Top 10</b>			<b>53.8</b>	<b>39.1</b>

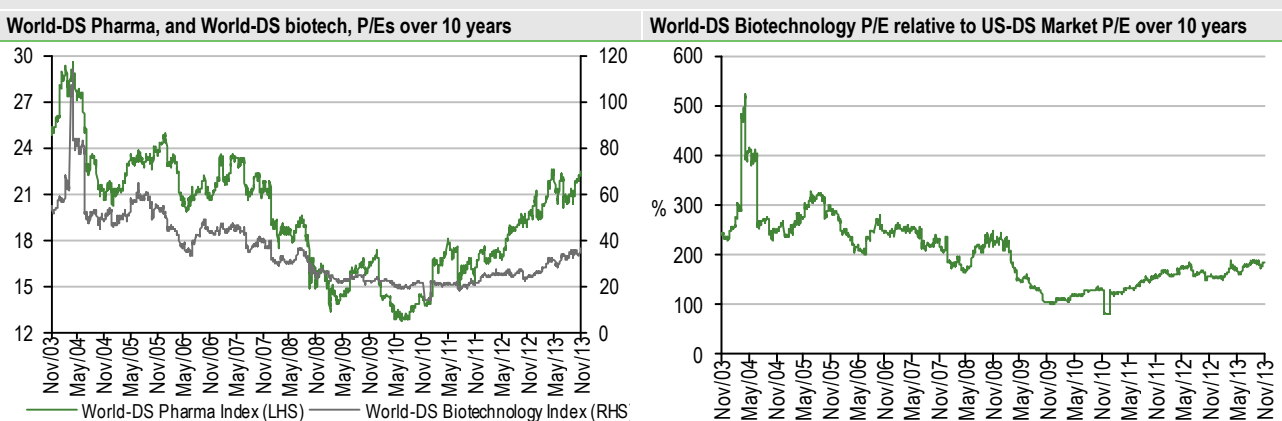
Source: International Biotechnology Trust, Edison Investment Research. Note: \*Geographic distribution is as a proportion of total assets.

## Equity outlook: Growing market, valuations rising

The healthcare and biotech sectors benefit from a demographic backdrop with increasing demand from ageing populations, particularly in the western world, and growth in population and utilisation, particularly in emerging markets, where healthcare in general is typically a disproportionate beneficiary from income growth. Big pharma, the largest subsector within the healthcare space (55% of the MSCI Global Healthcare Index), has traditionally excelled at sales and marketing, but has frequently struggled to replace revenue as drugs have gone off-patent, despite spending large sums on R&D. Biotech companies, by comparison, have frequently been smaller, more focused and, in recent years, experienced stronger success in R&D. This has seen an evolution whereby large-cap pharma and biotech companies are increasingly reliant on externally sourced drugs. The rewards for discovering effective treatments are high, making biotech an attractive place to invest, but the associated risks also remain high. This high risk and the need to understand the complex science that will often determine the success or failure of healthcare and biotech companies are strong arguments for investing via a portfolio managed by sector experts.

The biotech sector has performed strongly during the last five years (the NASBIOT is up 192% in sterling-adjusted total return terms), particularly during the last two years (up 111%), when the sector has experienced a re-rating. Price gains were initially matched by earnings increases, so valuations remained near historic lows, but the expansion in valuations during the last two years potentially leaves the sector more vulnerable to a correction, (the P/E has risen from c 21x to c 36x). Our analysis shows there have been five significant corrections during the past five years, which on average have seen the NASBIOT fall 17%. However, in each case the sector has recovered. Recent performance has led to talk of a bubble in the biotech sector. As illustrated in Exhibit 2, biotech P/E ratios traded at a premium to the total US market from 2003 to 2009, albeit this premium was on a declining trend. Having reached parity in 2009, the trend has been an expanding premium to the market since, but the premium remains below its 10-year average. Current healthcare and biotech P/Es (36.2x for the World-DS Biotech Index and 20.7x for the World-DS Pharma index) are broadly in line with the longer-term 10-year averages (35.7x and 18.3x). Progress from here for the biotech sector is likely to hinge on matching or surpassing estimated earnings growth, something the favourable secular drivers outlined above could support.

**Exhibit 2: Healthcare sector valuations**



Source: Thomson Datastream

## Fund profile: Quoted and unquoted biotech companies

Launched in May 1994, SVLS took over as adviser to IBT in November 2000 and became manager in January 2005. Kate Bingham has managed IBT's unquoted portfolio during SVLS's tenure. The most recent appointment is Carl Harald Janson (with effect from 2 September 2013) and, while it is

still early days into his tenure, his approach appears to have much in common with that of his predecessor David Pinniger (manager of the quoted portfolio between February 2008 and July 2013). The quoted portfolio continues to have c 40 holdings with a strong focus on active management around binary events. One key change is a shift towards a more neutral large-cap weighting, relative to the benchmark. Carl Harald has six years of operational experience within pharma and biotech (four and a half years as medical advisor clinical research and director preclinical research at Astra Arcus – now AstraZeneca, and one and a half years as CEO of KDev Oncology, Akinion and Axelar). He also 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.

Because IBT has traditionally had a significant unquoted element, there has been no unique benchmark against which to adequately assess its NAV performance. However, following a change in the performance fee structure in 2011, IBT now primarily evaluates its quoted performance against the NASBIOT.

## Fund managers: Carl Harald Janson and Kate Bingham

### Managers' view: Biotech valuations reflect growth prospects

**Exhibit 3: Large-cap biotech and pharma P/E multiples, as at 27 November 2013**

Top biotech	IBES EPS CAGR (%)	Current P/E	Forward P/E	2015 P/E	2016 P/E	Forward PEG	Top pharma	IBES EPS CAGR (%)	Current P/E	Forward P/E	2015 P/E	2016 P/E	Forward PEG
Amgen	9.2	15.3	14.1	13.0	12.1	1.5	Pfizer	4.4	14.6	13.8	13.3	13.5	3.1
Gilead	34.5	37.5	23.7	14.9	11.7	0.7	JNJ	6.9	17.3	16.2	15.1	14.1	2.3
Biogen IDEC	20.9	32.8	25.3	21.0	17.7	1.2	Merck	2.6	14.2	14.2	13.3	12.3	5.5
Celgene	22.9	26.9	22.1	17.0	13.3	1.0	Abbvie	1.5	15.4	15.3	13.3	11.9	10.2
Alexion	29.0	40.9	36.1	29.2	23.0	1.2	Bristol Myers	16.0	29.4	26.5	27.9	25.4	1.7
Regeneron	24.9	37.0	30.3	27.3	25.2	1.2	Lilly	0.1	12.1	18.1	15.7	12.4	150.6
<b>Median</b>	<b>23.9</b>	<b>34.9</b>	<b>24.5</b>	<b>19.0</b>	<b>15.5</b>	<b>1.2</b>	<b>Median</b>	<b>3.5</b>	<b>15.0</b>	<b>15.7</b>	<b>14.2</b>	<b>13.0</b>	<b>4.3</b>

Source: IBES, Bloomberg.

The managers acknowledge recent multiple expansion, but consider that, while biotech could be vulnerable to a near-term correction, the sector is not in a bubble and for investors able to take a longer-term view, valuations are currently attractive. Biotech has undergone a fundamental change since the biotech boom of 1999/2000 and significant investment has been made in R&D. This, along with a proliferation of new technologies, has driven the delivery of a strong new product cycle, leading to strong sales and EPS growth. This trend is expected to continue. The managers strongly believe that large-cap biotech's current P/E premium over large-cap pharma, is justified because of biotech's superior growth prospects. Large-cap biotech valuations are comparable to longer-term averages, but, as illustrated in Exhibit 3, looking forward to 2016 earnings, price earnings multiples are more comparable. The growth premium is also reflected in biotech's more favourable PEG ratios. The biotechnology industry as a whole is now cash flow positive as compared to a decade ago when it was in an earlier stage of development.

## Asset allocation

### Investment process: Research driven with top-down overlay

The investment manager uses four stages to manage IBT's investments: 1) Asset allocation: the top-down part of the process, which determines the sectors favoured by the manager. This sets the portfolio's target structure, weightings and exposures; 2) Idea generation: investment ideas are generated from a range of internal and external sources. These include the SVLS team, strategic

partners, medical investor conferences and recommendations from specialist brokers and analysts; 3) Review: investment ideas are reviewed and detailed analysis is undertaken. This uses SVLS's specialist knowledge and experience, which ultimately leads to an investment committee decision; and 4) Position management: once included in the portfolio, positions are subject to continuous evaluation and risk management. When considering stocks for inclusion in IBT's portfolios, the managers look for areas with high medical need (serious diseases that can support a high price) with well understood disease mechanism (improving significantly the chance of success). Strong emphasis is given to both a product's life cycle (availability of intellectual property rights) and the quality of a company's management. Within the quoted portfolio, the manager looks both to de-risk binary events and actively trade around holdings so liquidity in a company's stock also remains a key consideration. Unquoted holding valuations are re-valued on a daily basis.

## Overview

As at 30 November 2013, IBT had 77 investments: 49 quoted and 28 unquoted. The top 10 holdings account for 54% of total assets, while other quoted holdings account for 32%, unquoted holdings 14% and cash 0%. The majority (91%) is invested in North American stocks; IBT therefore has a significant dollar exposure (it is not policy to hedge foreign currency exposures).

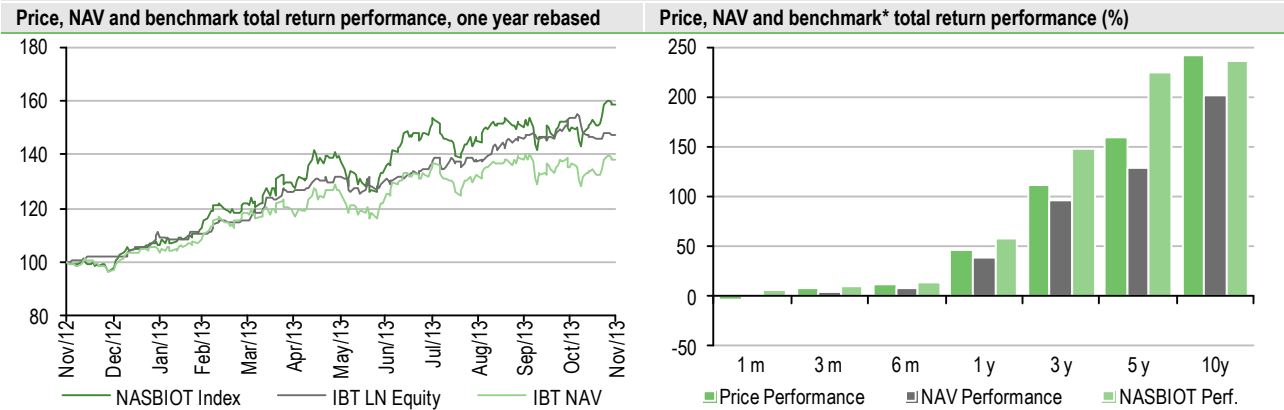
## Recent activity and current portfolio positioning

Having previously been underweight the key large-cap stocks in the quoted portfolio (relative to the NASBIOT) the new manager has moved Gilead Sciences, Amgen, Celgene and Biogen Idec to more neutral weightings. In contrast, IBT's previous overweight to small-cap stocks has been reduced with a particular focus on removing less liquid names from the portfolio. Unquoted holdings are expected to remain between 10% and 15% of IBT's portfolio in the near term. During the last 18 months, unquoted holdings have been rebalanced towards more mature companies (primarily US healthcare services, which now account for c 40% of the unquoted portfolio) and away from earlier-stage investments (primarily early stage medical devices companies, which now account for c 21% of the unquoted portfolio). This change has been implemented with a view to minimising extended holding periods and structured exits. In terms of sector allocations, as at 30 November 2013, therapeutics accounted for the bulk of investments at 81%, with the balance in medical devices, life science tools and diagnostics, specialty pharma (see Exhibit 1).

## Performance: Unquoted performance improvements

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As Exhibits 4 and 5 illustrate, IBT has provided strong absolute returns during the last 10 years but has underperformed its benchmark index, the NASBIOT, in terms of both price and NAV total return (sterling adjusted) over one, three and five years to 31 October 2013. Separating the NAV performance of the quoted and unquoted parts of the portfolio (see Exhibit 6) shows that both the quoted and unquoted portfolios have underperformed the NASBIOT over the time periods provided to 31 August 2013, with the exception of the price performance over three months. While the performance of the unquoted investments has been respectable in absolute terms (17.5% over one year, 38.0% over two years) it has substantially lagged that of the quoted portfolio during the last three years, when listed biotech equities have experienced a substantial re-rating. However, given that the unquoted holdings have traditionally provided returns uncorrelated with equity markets, they are likely to support performance in the event of a sell-off in listed biotech. During the year to 31 August 2013, the quoted portfolio's NAV benefited from three companies being acquired, YM Biosciences (by Gilead in February), Life Technologies (by Thermo Fisher in April) and Onyx Pharmaceutical (by Amgen in August). The manager reports that relative performance was tracking in line with that of the benchmark up until the spring when Regeneron, Vertex and Biogen Idec all performed particularly well, and IBT was significantly underweight those names.

**Exhibit 4: Investment trust performance to 30 November 2013**


Source: International Biotechnology Trust, Thomson Datastream, Edison Investment Research. \*Note: 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, versus benchmarks (% points), to 30 November 2013**

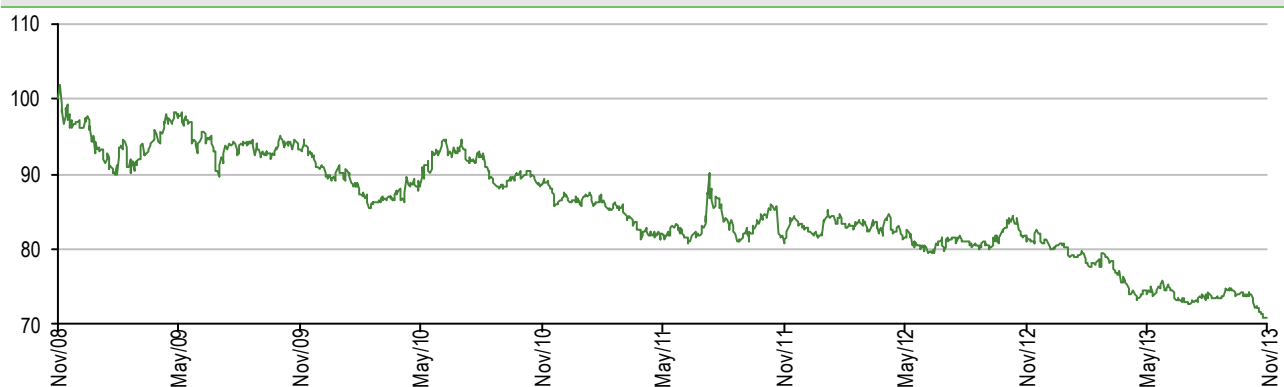
	One month	Three months	Six months	One year	Three years*	Five years*	10 years*
Price versus NASBIOT	(9.5)	(1.7)	(1.7)	(11.4)	(36.8)	(64.4)	6.6
NAV versus NASBIOT	(4.1)	(4.9)	(5.0)	(20.7)	(51.6)	(94.4)	(34.8)
Price relative MSCI World Healthcare	(4.7)	2.0	8.2	14.2	34.6	40.2	84.1
NAV versus MSCI World Healthcare	0.7	(1.2)	5.0	4.9	19.9	10.1	42.6
Price versus FTSE All-Share	(2.1)	2.9	9.2	27.7	73.5	61.0	108.6
NAV versus FTSE All-Share	3.3	(0.3)	5.9	18.4	58.7	30.9	67.1

Source: International Biotechnology Trust, Thomson Datastream, Edison Investment Research. See note in Exhibit 4.

**Exhibit 6: Quoted and unquoted NAV total return performance and benchmark performance (sterling adjusted), to 30 November 2013 (%)**

	Three months (%)	Six months (%)	One year (%)	Two years (%)	Three years (%)*
Quoted portfolio NAV	5.4	12.5	41.7	98.5	119.9
Unquoted portfolio NAV	0.4	3.8	17.6	41.3	26.0
NASBIOT	9.4	16.1	58.3	111.2	145.1

Source: International Biotechnology Trust, Thomson Datastream, Edison Investment Research. See note in Exhibit 4.

**Exhibit 7: IBT NAV total return vs NASBIOT total return, over five years, rebased to 100**


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

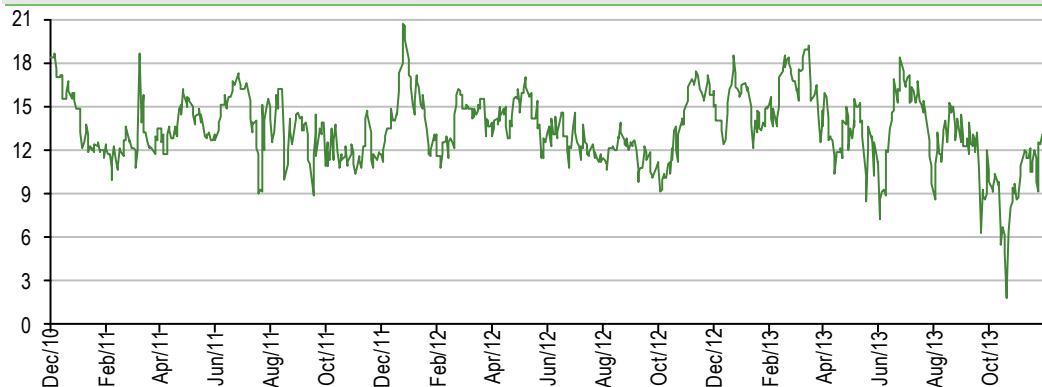
For the unquoted portfolio, the primary contribution came from the revaluation of milestone payments in relation to ESBATech, EUSA Pharma, Ikano Therapeutics and Itero Holdings. These collectively added 6.3p per share to NAV. Two key detractors from the unquoted portfolio's performance were Lux Biosciences and Vantia. The value of Lux was written down from £1.3m to zero following the failure of its key drug candidate for eye inflammation to show any treatment benefit. Similarly, Vantia was written down from £0.6m to zero when its Phase IIb drug trial for Nocturia did not generate the statistical data expected, although the drug demonstrated safety and efficacy.



## Discount: Widened during the last six months

As part of the c-share issue in February 2007, a target discount of 8% (subject to market conditions) was introduced, but its implementation was initially limited by insider knowledge on unquoted investments until arrangements were revised. The discount reached a five-year low in June 2013, immediately prior to the announcement of David Pinniger's departure from SVLS. The discount subsequently expanded to c 19%, but tightened significantly, reaching a new five-year low of 1.8% at the beginning of November. The current cum-income discount of 13.4% is below its three- and five-year averages of 13.5% and 15.4%, but above the target of 8%.

**Exhibit 8: Discount calculated with NAVs, including income**



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

## Capital structure: Conventional, modest gearing

IBT is a conventional trust, having only one class of share in issue – 25p ords. There are no formal limits on gearing, but the manager and board do not expect borrowings to ordinarily exceed 10% of the quoted NAV on a short-term basis, avoiding longer-term structural gearing. Reflecting this, IBT has a £15m overdraft facility, which is drawn down at the manager's discretion. As at 30 November 2013, IBT had nil borrowings and had no cash. SVLS receives a management fee of 1.15% of net assets per year paid monthly in advance. The performance fee for the quoted portfolio is 10% of any outperformance over the NASBIOT plus 0.5%. IBT pays an annual performance fee of 20% of any net gains made on the unquoted portfolio. In addition, there are three conditions for a performance fee to become payable. First, IBT must have experienced NAV appreciation during the year. Second, paying the performance fee cannot cause IBT's NAV to fall below its value at the start of the year (if this happens the fee is deferred and added to the next performance fee, as long as it is within 24 months). And third, the fee cannot exceed 3% of IBT's closing NAV (any excess is placed in escrow and adjusted to reflect the share price performance over the next 12 months). No performance fee was accrued for the year ending 31 August 2013 (or 2012). IBT's ongoing charges were 1.70% for the year ended 31 August 2013 (2012: 1.86%). IBT's ongoing charges remain above its peers, but the difference is not unreasonable given the specialist resources required to manage the unquoted portfolio. IBT has an indefinite life; however, a continuation vote is put to shareholders every two years (the next vote is due at the December 2015 AGM).

## Dividend policy and record: None; capital growth focus

IBT's investment objective is to achieve long-term capital growth by investing in development-stage biotechnology and other life sciences companies. Such companies will, if successful, be at a growth

stage and will typically retain earnings in full for reinvestment. As a result, IBT's dividend income is comparatively small in relation to movements in the capital reserve and is more than offset by expenses that are charged against it. As such, it is IBT's policy not to declare dividends.

## Peer group comparison

As Exhibit 9 illustrates, the biotechnology/life sciences specialist sector is a relatively small peer group. There are five constituents and, while they all invest in biotechnology companies, their investment objectives are markedly different. IBT invests in high-growth development-stage quoted and unquoted biotechnology companies, while The Biotech Growth Trust invests primarily in emerging biotechnology companies. Worldwide Healthcare Trust invests in biotechnology and pharmaceutical companies, and the Polar Capital Global Healthcare Growth and Income Trust is a fixed-life vehicle that pays quarterly dividends. BB Biotech is a large Swiss-domiciled fund, focused on mid-cap biotech companies. Within this group, IBT ranks fourth over one-year, third over three-years and fourth over five-years, when considering share price total return. IBT has the lowest one-year Sharpe ratio for NAV and second highest one-year Sharpe ratio for price among this peer group.

**Exhibit 9: Sector specialist: biotechnology/life sciences sector, as at 16 December 2013**

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
	One year	Three years	Five years							
<b>Sector average</b>	<b>152.3</b>	<b>233.9</b>	<b>316.6</b>	<b>1.3</b>	<b>(13.3)</b>	<b>99.7</b>	<b>27.0</b>	<b>2.7</b>	<b>2.5</b>	<b>2.6</b>
<b>International Biotechnology Trust</b>	<b>141.3</b>	<b>200.7</b>	<b>248.0</b>	<b>1.7</b>	<b>(12.7)</b>	<b>100.0</b>	<b>0.0</b>	<b>0.0</b>	<b>2.1</b>	<b>2.7</b>
Biotech Growth Trust (The)	143.6	263.4	384.7	1.3	(5.0)	109.0	0.0	0.0	2.5	2.7
Polar Capital Global Healthcare	117.0	148.6		1.1	(4.4)	99.0	0.0	2.4	2.1	1.4
Worldwide Healthcare Trust	146.0	190.9	271.0	0.7	(1.3)	112.0	27.0	1.4	2.5	3.1
BB Biotech AG	162.8	260.3	329.6	1.5	(21.9)	92.0	0.0	3.4	2.6	2.4

Source: Morningstar

## The board

All directors are non-executive and independent of the investment manager. They are Alan Clifton (chairman), John Aston, Dr Véronique Bouchet, Dr David Clough and Jim Horsburgh (directors). The average length of board member service is 5.0 years.

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