OPTO

TRADING INTELLIGENCE

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13 BIOTECH stocks to watch

NOT FOR THE FAINT OF HEART

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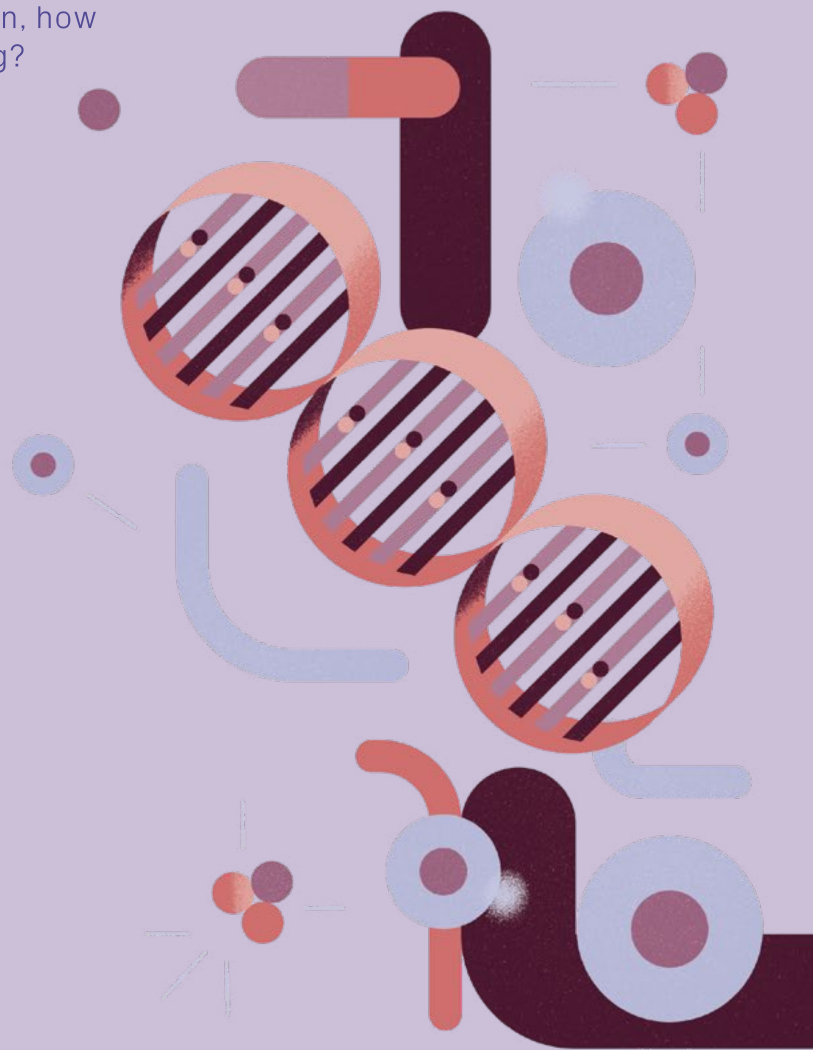
Last year ended in a biotech bonanza. Not only did the SPDR S&P Biotech fund outperform the healthcare industry, but also the broader market by 2%. With the sector experiencing accelerating innovation, how can investors spot the next big thing?

- Pfizer [PFR]
- CVS Healthcare [CVS]
- Roche [RHHBY]
- Crispr Therapeutics [CRS]
- Vertex Pharmaceuticals [VRTX]
- Blueprint Medicines [BRMC]
- Global Blood Therapeutics [GBT]
- Neurocrine Biosciences [NBIX]
- EXACT Sciences [EXAS]
- Bristol Myers Squibb [BMY]
- Novartis [NVS]
- Biomarin [BMRN]
- Gilead [GILD]



1 —
IN AN EFFORT TO "DEMOCRATISE HEALTHCARE", A YOUNG 26-YEAR-OLD TECH CEO STOOD UP ON STAGE AT TEDMED IN 2014 AND TOLD THE WORLD:

> "We've made it possible to run comprehensive laboratory tests from a tiny sample or a few drops of blood that could be taken from a finger"

The process, Elizabeth Holmes suggested, was so simple. Through the use of nanocontainers and a machine dubbed the "Edison", just a small drop of blood could be processed more easily, more efficiently, and most importantly, at a fraction of the cost of previous tests.

Famed investor James Mattis at the time described Holmes as "a revolutionary in the truest sense". However, just two years after that speech her company Theranos, once valued as high as $10bn, had begun to collapse. Holmes, meanwhile, was left facing charges of fraud, the trial of which will take place later this year.

The potential impact for these companies to transform healthcare – and by extension save lives and improve the wellbeing of many – is as exciting as any other technological breakthrough because good health, or a lack thereof, is a factor that affects not just investors, but everyone.

However, as the Theranos case shows, a healthy dose of scepticism is required. Afterall, there are plenty of businesses that are, rightly or wrongly, being lauded as the latest drivers of radical change – change that a lot of people are desperate for. The level of innovation is accelerating too, as these products are becoming more revolutionary rather than evolutionary, explains Andy Acker, portfolio manager at Janus Henderson.

"There are more new products coming out than we've ever seen before," Acker tells *Opto*. In the last three years alone 150 new medicines have been approved in the US — more than double from a decade ago — he points out.

It is no surprise, therefore, that investors can get bewildered by the wealth of promising biotech innovations. But what are these new and exciting biotech offerings and, more importantly, how are they performing?

BIOTECH PERFORMANCE TIMELINE

A series of events that led to a biotech breakout

↓24%

• JULY 2015
The biotech bubble bursts. The SPDR S&P Biotech ETF [IBB] plunges 24% from its peak of $131 to just $99 in two months

↑26%

• DECEMBER 2019
Biotech stocks breakout. The IBB enjoys a three-month rally, climbing 26% from $97 at the start of October to a 15-month high of $123 on 24 December

• SEPTEMBER 2015
US politician Hillary Clinton exasperates the biotech tumble by tweeting that she would propose a plan to counteract the "outrageous price gouging" by drug makers

• JULY 2012
The patent cliff. Pfizer [PFE] sees revenues from its drug Lipitor fall by $296m in Q2. In the same quarter, Eli Lilly [LLY] reports a 10% decline in revenue due to the expiration of its Zyprexa drug patent

• APRIL 2003
The Human Genome Project is completed, driving innovation and development in the biotech space

IS A LACK OF DEALS A SIGN OF FALTERING MOMENTUM?

The industry's biggest conference, the annual JPMorgan Healthcare Conference, often sets the stage for any massive takeover deal announcements, which in turn acts like a springboard for share price momentum.

Last January a pair of giant transactions — Bristol-Myers Squibb's [BMY] $74bn merger with Celgene and Eli Lilly's [LLY] $8bn acquisition of Loxo Oncology — initiated a flurry of M&A activity,but the sector hasn't seen the same happen this year. This is unusual given that over the last five years January typically sees 33% of a year's total deals, Evercore ISI analyst Josh Schimmer points out.

Andy Acker, portfolio manager at Janus Henderson thinks the appetite for M&A activity remains high, "with the top 20 biopharmaceutical companies generating over $150bn a year in free cash flow".

Many analysts believe the US election is the cause for the disruption, as last year's influx of private equity and venture capital investment suggests that momentum had been picking up. In 2019 there had been 61 IPOs, as of October, with 127 biotech companies being acquired, according to a report from Deloitte.

Without the excitement at the start of the year of the world's biggest drug makers snapping up their small-cap peers, biotech will have to work extra hard to close the gap with the broader market.

2 — A HEALTHY INVESTMENT

In the past year alone, a plethora of companies have been working on an array of innovations from gene therapies and stem-cell treatments, to Alzheimer's and personalised medication. In particular, the field of oncology (treatments related to cancer) has made leaps and bounds as genomic testing has helped find new treatments.

This in particular has helped raise the profile of pharmaceutical behemoth Roche [RHHBY]. Valued at $280bn, shares in the Swiss giant are at an all-time high (above the $43 mark at the time of writing), giving it an attractive PE ratio of 27.06 (TTM) compared to the industry's 25.73 average. Roche's work in using DNA to find cures for cancer has made it a market leader in both biotech and diagnostics.

Roche is also the parent company of Genentech. Credited with starting the modern biotech industry, the company's most notable discovery was in 1978 when its scientists managed to genetically engineer human insulin. Their discovery created an alternative, cost efficient solution to fill the increasing demand for the drug in the US.

The current outlook for the burgeoning class of gene-editing technology known as CRISPR is to surpass revenues of $85bn by 2023, and the broader oncology market to hit $196.2bn by 2026, according to research from Global Market Insights and Coherent Market Insights. This places companies such as Crispr Therapeutics [CRS], Vertex Pharmaceuticals [VRTX] and Blueprint Medicines [BPMC] at the forefront of investor's attention.

3 — NAVIGATING A BIOTECH FIRM'S JOURNEY: FROM IDEA TO INNOVATOR

When it comes to investing in biotech although there's potential for large profits it is a notoriously volatile sector. Furthermore, there are few sectors in the market that see small single product companies go from tiny market capitalisations to being worth hundreds of millions (practically) overnight. This, unsurprisingly, makes it a game of Operation for traders looking for opportunity.

There are typically two types of companies to invest in. The first and the majority are those without any profits — or even sales — that are chasing a scientific breakthrough. Graduated megacaps make up the rest.

	[GBT] GLOBAL BLOOD THERAPEUTICS	**[NBIX]** NEUROCRINE BIOSCIENCES	**[VRTX]** VERTEX PHARMACEUTICALS
SHARE PRICE GAIN	443% 30 December 2016 – 2 January 2020	179% 30 December 2016 – 2 January 2020	197% 30 December 2016 – 2 January 2020
INFORMATION	Based in San Francisco, GBT has developed a treatment for sickle cell disease. A genetic defect that affects the haemoglobin of an estimated 100,000 people in the US.	Half a million people in the US suffer from movement disorder Tardive dyskinesia, so it's no wonder Neurocrine's new treatment made $750m in sales only two and a half years after launch.	Vertex recently received drug approval for its treatment of genetic condition cystic fibrosis, which is set to help 90% of the estimated 30,000 people in the US who suffer from it.
PRICE TO BOOK RATIO	6.22	16.26	9.74
NET INCOME (TTM)	$219m	$20m	$2.14bn
TOTAL EQUITY (Q3 2019)	$658m	$570m	$5.2bn

Source: Morningstar 31.01.20

Because the risk of a product not making it to market is often high, understanding the complexities of how a particular treatment works is vital (see *How to value a promise*, overleaf). This helps determine if a particular company is a worthwhile investment and if so can help to avoid the inflated spikes that often occur after a company successfully passes a phase of testing.

These spikes can be somewhat predetermined by a number of events such as FDA approval, trial data releases between phases of testing, earnings calls or rumours of potential M&A deals.

But investing in biotech isn't a short-term bet. Nathan Fischer, chief investment strategist at Strategic Wealth Management, tells *Opto* that he "tends to favour companies that have an existing product portfolio in the market to reduce FDA approval risk". Fischer is bullish on EXACT Sciences [EXAS], Bristol-Myers Squibb [BMY] and Novartis [NVS], for example.

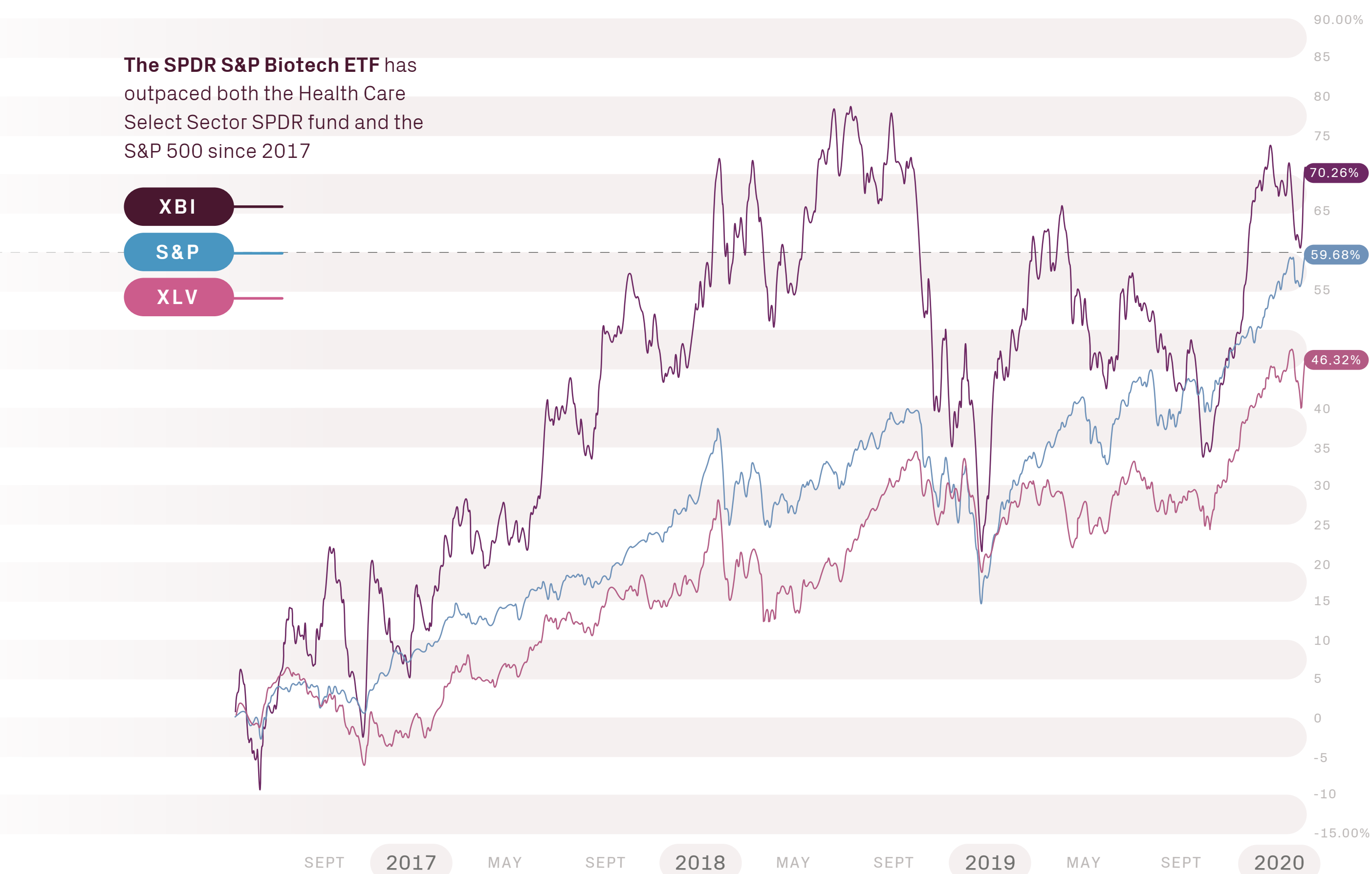
4 — SPOTTING BIOTECH BREAKOUTS

Even when the underlying drivers of a biotech stock are understood, it is still an uncertain market, "especially for smaller firms without much diversification in their product portfolios", Damien Conover, director of healthcare equity research at Morningstar tells *Opto*.

Furthermore, Conover adds, the trend in larger biotech companies becoming more like big pharmaceutical firms will lower this uncertainty and, looking at the most recent P/E trends, he sees biotech stocks as undervalued.

In Conover's latest coverage of the sector, BioMarin Pharmaceuticals [BMRN] was singled out as underappreciated. In fact, the firm is so attractive that it would be a good takeover target as part of the sector's M&A trend (see *Is a lack of deals a sign of faltering momentum?* on p15) . The $15.9bn valued company is a major player in the treatment of rare genetic diseases and has a strong pipeline of products in the gene therapy market. Conover has

The SPDR S&P Biotech ETF has outpaced both the Health Care Select Sector SPDR fund and the S&P 500 since 2017



Source: TradingView 10.02.20

a fair value estimate of $119 on the stock, suggesting a 35.7% rise from levels at the time of writing.

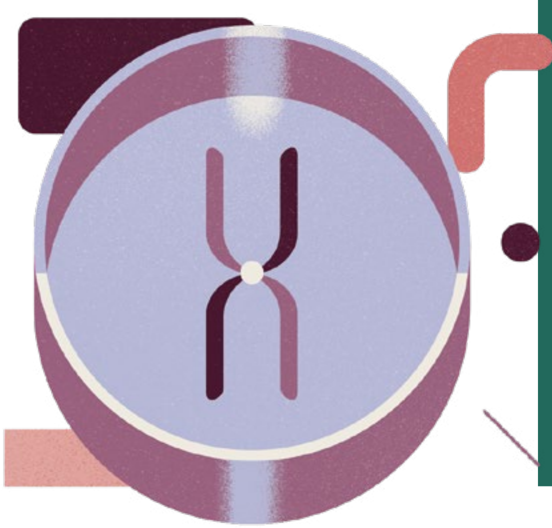
Conover also points to Pfizer [PFE] and CVS Health [CVS] as two companies with strong long-term growth. His outlook for the year is largely positive: "Overall, the fundamentals for healthcare look solid and the innovation going on in drug development is some of the strongest that I have ever seen over the past two decades."

5 — PUSHING BOUNDARIES

Before the 1990s biotech barely existed, let alone any interest in trading it. While the completion of the Human Genome Project in the early 2000s peaked interest in the area, this biotech bull market only really started to build pace in 2009 and the iShares Nasdaq Biotechnology index [IBB] broke out in 2012 amid a flurry of biotech IPOs.

This was the same year in which the industry was facing a long feared period referred to by some as the patent cliff. During this period, large blockbuster products like Lipitor (commonly known as atorvastatin, used for treating cardiovascular disease) were facing patent expiration. In the months following, the IBB index entered a powerful trend advance that topped out at $131.52 during the height of the biotech bubble in 2015.

The index tumbled more than 36% in the eight months following the burst, as analysts warned of substantially stretched valuations. Scandals involving Valeant Pharmaceuticals (now Bausch Health Companies [BHC]) and Martin Shkreli's Turing Pharmaceuticals hit the headlines following concerns of price manipulation fuelled by the threat of stricter drug price regulation in the US.



"Of all the therapeutics that are put into human clinical testing, 90% of those drugs will never make it to market"

ANDY ACKER, JANUS HENDERSON

HOW TO VALUE A PROMISE

For Andy Acker, medicine runs in the blood. As the portfolio manager for Janus Henderson's global life sciences and biotechnology strategies, a family lineage of physicians has stood him in good stead.

Acker, who started investing in the sector more than 20 years ago, knows better than anyone the risks associated with a sector in which "it's difficult to figure out whether a product is ultimately going to work and be clinically and commercially successful".

When Janus Henderson is investing in therapeutics – 30% of the firm's healthcare fund is invested in biotech – Acker explains that they refer to what he calls the 90-90 rule. "That's our framework for essentially trying to create value as we invest in this very exciting but also quite volatile market that is biotechnology."

Clinical risk is the first factor to consider, after all "we have to remember that of all the therapeutics that are put into human clinical testing, 90% of those drugs will never make it to market".

Acker explains that on average only one in 10 drugs will make it through all three phases of clinical development and gain regulatory approval. The approach to understanding the science and the business is to "essentially pick the needle in the haystack".

Acker and his team use a deep fundamental research approach whereby they meet with key industry leaders, conduct surveys and study clinical literature, all the while "using statistical models to analyse the probability of success".

If they're successful in finding a needle, then next comes part two of the rule – commercial risk. "What we have found in more than two decades of observing this market is that the consensus estimates from Wall Street for new product launches are wrong about 90% of the time," he explains.

But with a bit of digging, Acker aims to find products that outperform expectations and ultimately "create a lot of value for their shareholders and for patients".

An overall sector decline ensued that's carried on up until the end of last year. While the benchmark index hasn't managed to quite recover since the 2015 peak, the sector is currently enjoying a three-month rally and is forecast to exceed $729bn by 2025, according to research by Global Market Insights.

The IBB climbed 21% in the three months since the start of October to above the $120 mark while the SPDR S&P Biotech ETF [XBI] rose 26.54% in the same period of time. Both funds have outpaced the broader Health Care Select Sector SPDR fund's [XLV] 14.43% gain.

Fischer says there are three primary forces driving the rally. These include the announcement of a partial trade deal between the US and China, which elevated interest in growth sectors, a cooling of rhetoric surrounding drug price regulation in Washington and sentiment for healthcare improving with the odds of senators Elizabeth Warren or Bernie Sanders winning the election recently slimming.

6 —
AN APPETITE FOR RISK

The recent outperformance of the sector is an indication that investors are in a risk-on mood at this point in time. However, not everyone agrees. One biotech investor, who preferred not to be named, told research firm Vantage in its 2020 outlook report that the recent momentum was being driven by funds that have been taken by surprise from the uptick across global indices. "The indices have run and most funds need to play catch up so are going after everything without much due diligence," the report read.

> "What I've been seeing for about the last four years is a market that's just been forming this tightening symmetrical consolidation"

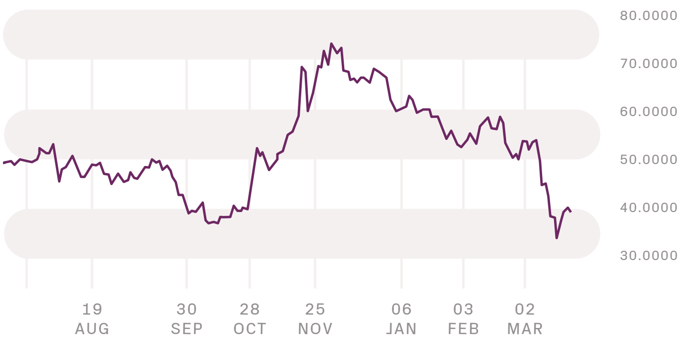
However, Craig Johnson, technical market strategist at Piper Sandler, still believes the sector has room to work. "What I've been seeing for about the last four years is a market that's just been forming this tightening symmetrical consolidation," Johnson tells Opto. He highlights the recent price action in BioMarin, Gilead [GILD] and Vertex as beginning to look more constructive.

"And usually when I see that, it's typically a sign that the market is sort of paused and then you typically resolve that kind of consolidation in the direction of the preceding trend, which in this particular case was up," Johnson explains, adding that he thinks we will witness "a further expanding of overall market breadth, meaning more stocks participating, and more stocks participating is going to be an indication of a healthier market."

Johnson also feels that investors won't see a continuation of growth but rather that there will be a shift towards value throughout the year. His outlook tells of a market that has come full circle. However, with the words of Holmes still haunting Silicon Valley today, traders and investors alike have learnt a valuable lesson in due diligence. Let's just hope they do their homework. ●

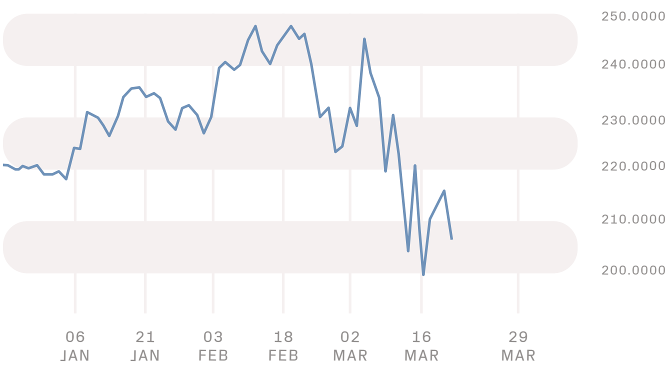
AN ANALYSTS VIEW

David Madden, market analysts at CMC Markets, provides his analysis and commentary on how the following stocks have been performing recently and what this means for their outlooks.



CRISPR THERAPEUTICS

The stock has been driving lower since early December. Support might be found at $30.00. A turnaround in the stock might encounter resistance at $53.00.



VERTEX PHARMACEUTICALS

has been in a bearish trend for one month, and further losses might find support at $190.00. A break above $220.00 might pave the way for $230.00 to be tested.

PFIZER

The stock has been driving lower since January and if the bearish move continues it might target $27.00. A pullback might run into resistance at $32.70.