Results analysis: International Biotechnology Trust

IBT has delivered strong outperformance in a tough environment…

Update
13 November 2023

- **The quoted portfolio, which represents 91.6% of IBT's total investments, rose by 3.8% during the financial year ending 31/08/2023, beating the Nasdaq Biotechnology Index by 5.2%, which fell 1.4% over the same period.**

- **Most of this outperformance was due to careful selection of mid cap revenue-generating biotech opportunities, which became acquisition targets. IBT benefitted from being overweight in six companies which were subject to M&A activity during the year. In particular, Horizon and Seagen represented the two largest portfolio holdings before they became the subject of takeover bids. In both cases shareholders benefitted significantly from the performance uplift, and the investment managers subsequently took the decision to reduce the positions to lower exposure to the transaction risks. This has proved prescient as both share prices have been volatile following announcements of investigations into the deals by the Federal Trade Commission (FTC).**

- **The unquoted portfolio, which comprises 8.4% of total investments, is primarily invested in two venture capital funds, SV Fund VI and SV BCOF. SV Fund VI, which is mature, with 86% of the initial IBT $30m commitment drawn down, fell in value with a number of write downs. Nevertheless, since its launch in 2016, SV Fund VI has delivered a currency adjusted Internal Rate of Return (IRR) of 17.7% per annum for investors. SV BCOF focuses on later stage, pre-IPO and newly listed opportunities. Of the initial $30m commitment from IBT, only 28% is drawn down, and invested in six companies. During the year, Nimbus, one of the original investments, announced the sale of one of its key assets. This has led to an exceptional early return for investors in SV BCOF which has delivered a currency adjusted IRR of 109% since it was launched in January 2022.**

- **The transition of management to Schroders, which is due to occur on 20/11/2023, ensures continuity of the existing mandate combined with the benefit of the significant investment trust expertise which Schroders brings to the table. Ailsa Craig and Marek Poszepczynski are moving to Schroders and will continue to manage the quoted portfolio with the same investment philosophy.**

- **The outlook for M&A activity in the sector seems bright. Smaller, innovative companies which are developing the drugs of the future are being taken over by cash-rich, large cap companies, which are under pressure to maintain earnings growth and are eager to fill their product pipelines. Whilst higher costs of capital have had a substantial effect on the funding environment for early stage drug discovery companies, the fundamentals of the sector arguably remain very much intact: namely a growing elderly population, a rising middle class, and an increasing demand for treatments to cure disease and enhance the quality of our lives. This spend is, to a large degree, non-discretionary.**

- **Chair Kate Cornish-Bowden said: "We are excited about the opportunities for IBT within the Schroders stable and are looking forward to the future with confidence".**

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Kepler view

The underperformance of the biotechnology sector globally may pique the interest of contrarian investors, it now having had a third successive year of difficult markets. The team point to demographics and the cyclicality of the biotech sector as long-term supporting factors which mean it may be an interesting time to look at the sector.

That said, Biotech remains a high-risk area of the stock market, arguably best navigated by experts in this complex field. Over the last financial year, **International Biotechnology Trust (IBT)** has continued to do the job for investors that it has long aimed to do: deliver outperformance of the benchmark, with lower volatility. Ailsa and Marek have achieved this through their pragmatic, valuation-sensitive approach, with a strong focus on risk management. As the chairman's statement explains, maintaining portfolio diversification through active trading activity has been key to minimising volatility and protecting capital – even after large holdings in the portfolio have been bid for.

IBT remains exposed to the most innovative areas of science. Within the unquoted portfolio, it is very encouraging that the SV BCOF fund has had such an impressive early win, and shows the high return potential from investing in private markets. Within the listed equities portfolio, the managers are recycling proceeds from M&A into small and mid-cap opportunities, whose share prices have been hit hard by global risk aversion. Rather than make binary bets on specific companies, the team have identified clusters of smaller companies focussing on the same disease areas but with different technologies or approaches. Ailsa and Marek reason that it is impossible to determine which will be the eventual winner, and so this approach means that they do not have to back a single horse. With global pharmaceutical companies looking to broaden out and replenish their product suites, the IBT team hope to benefit from further M&A and low entry valuations. As such, the number of smaller and mid-cap companies in the portfolio has been rising significantly, as shown in the graph below.

Fig.1: Market Cap Allocation

Source: SV Health

We think IBT continues to provide an interesting combination of growth potential and yield, achieved through the board's policy of making dividend payments equivalent to 4% of the Company's 31/08/2023 NAV, through two semi-annual distributions. We understand this policy will not change after the managers' move to Schroders. IBT's dividend therefore provides a highly differentiated source of income for investors who would not otherwise have much of an opportunity to get exposure to the area.

Despite the distractions of the board negotiating alternative management arrangements, we think it is impressive that Ailsa and Marek have nonetheless outperformed the benchmark by a significant margin during the last financial year. The team have a clear focus in aiming to outperform the benchmark, with lower volatility. Over time, their approach has proven successful, and so we believe that investors will share the board's enthusiasm at the prospect of the pair's new home at Schroders. The move will formally occur on 20/11/2023, but we anticipate little change to the management approach. Schroders' considerable middle office resource, and expertise in managing investment trusts will clearly be beneficial. The board appear to be keeping the discount to NAV in check with buybacks, but if we see a turn in investor appetites for this specialist area of the market, we think this could be a potential catalyst to see the discount narrow.

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