Many happy returns

Why IBT has consistently outperformed the biotech sector…

Update
30 May 2024

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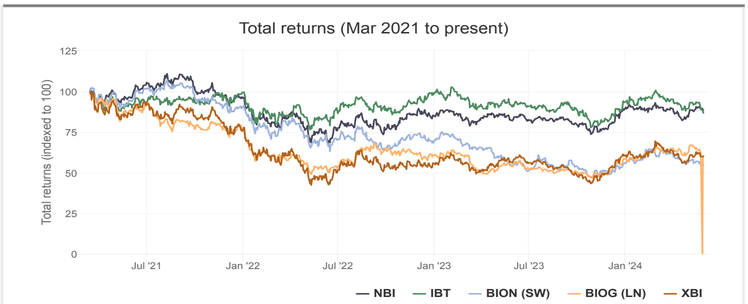
This year has ushered in a set of notable anniversaries for International Biotechnology Trust (IBT) with May marking the 30-year milestone since the trust's launch in 1994. Its performance is equally worthy of celebration, given that an initial investment of £1,000 at launch would have grown to almost £9,800 some 30 years later (on a total returns basis as at 29/05/2024, with dividends reinvested in shares).

On a similar note, Ailsa Craig and Marek Poszepczynski reached their three-year anniversary in March as joint lead managers of IBT. Despite considerable sector volatility, they have presided over a net asset value total return of 15% in IBT's quoted portfolio in the last three years (ended 31/03/2024), comfortably in excess of the 5% total return for the NASDAQ Biotechnology Index (NBI).

IBT has also consistently led the field against its biotech peers and the wider sector during Ailsa and Marek's tenure, as shown in the chart below:

Fig.1: Returns Under Current Managers



Source: Bloomberg (in local currency, from 15/03/2021 to 29/05/2024)
Past performance is not a reliable indicator of future results.

It therefore seems an opportune moment to run through some of the recent drivers behind IBT's success. The high level of M&A has been a significant contributor, with the acquisition of 23 portfolio companies since 2020. The large pharma companies have amassed substantial war chests to acquire innovative biotech firms to plug the widening gap from patent expiries, with Pfizer, Merck, Johnson & Johnson, AstraZeneca and Novartis among the buyers.

As a result, acquisition premiums have created a significant tailwind for returns, with Amgen and Gilead offering premiums of 116% and 108% respectively to acquire biotech firms ChemoCentryx and Immunomedics (based on the closing share price prior to the announcement).

Another differentiating factor is IBT's focus on the cutting-edge of biotechnology, with the current portfolio encompassing cell-based therapies to treat cancer, gene therapies for spinal muscular atrophy and haemophilia, RNA therapies and gene editing. This could pave the way for the treatment of previously untreatable diseases, though, in the most innovative areas, IBT tends to invest in a basket of companies addressing the same therapeutic area rather than speculating on one likely winner.

A standout success story is top ten holding Vera Therapeutics which has initiated phase three clinical trials for a disease-modifying drug for IgA nephropathy (a serious autoimmune kidney disease). Current treatments are focused on managing the symptoms, not treating the disease, and with up to 50% of patients currently needing dialysis or kidney transplants, this could prove a breakthrough development. The company's share price has risen by more than 360% in the past year (as at 29/05/2024) on the back of positive clinical trial data.

Older, richer, sicker

The biotech sector is well-positioned to benefit from strong secular growth drivers. The first of these is the 'demographic timebomb' of an ageing population, with the United Nations forecasting that the number of over-65s will soar from 800 million in 2023 to 2.5 billion by 2100. This has a knock-on effect on the number of 'sick' people requiring treatment, given the exponential increase in the prevalence of age-related diseases such as cancer, heart disease and strokes in the over-50s.

Lastly, healthcare expenditure as a percentage of GDP typically rises as countries develop, resulting in a likely rise in the expenditure by developing countries over coming decades. According to the IQVIA, Japan and Western Europe currently spend more than double per capita on medicine than most regions, showing the potential uplift in global expenditure if countries start to close this gap.

In our **recent webinar**, Ailsa and Marek outlined how the pharmaceutical industry has responded to soaring demand, with the number of new clinical trials (registered with global database clinicaltrials.gov) doubling over the last decade alongside a steady increase in the number of novel drug approvals by the U.S. Food and Drug Administration (FDA).

Challenging misconceptions

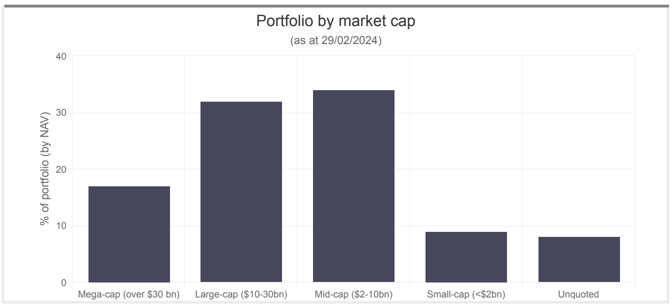
Despite its growing significance in the healthcare sphere, some UK investors still perceive the biotech sector as predominantly populated by small and highly-speculative early-stage companies. This misconception overlooks the significant evolution of the biotech sector over the past two decades, especially in the US, with the NBI turning cash positive (as a whole) more than 15 years ago.

Starting off with size, the biotech sector spans a diverse universe of companies and even the 'small-cap' category covers market caps of up to $2 billion (which wouldn't be too far off qualifying for the large-cap FTSE 100 in the UK).

Turning to the 'highly-speculative' tag, a high failure rate was a feature of the biotech sector in its infancy but this has fallen over time thanks to advancements in technology, research methods and regulatory frameworks. The biotech sector has proved its credentials in successfully navigating the drug approval process and currently accounts for more than two-thirds of global clinical trials, according to the IQVIA.

IBT looks to balance its exposure to early-stage companies with larger, more established companies to manage downside risk for investors. As shown in the chart below, over 80% of the portfolio is currently invested in $2 billion-plus market cap companies and 17% in 'mega caps' such as Amgen and Gilead (as at 29/02/2024).

Fig.2: IBT Portfolio Allocation By Size



Source: Schroders

This allocation is flexed according to the stage of the biotech cycle, with Ailsa and Marek starting to tilt the portfolio towards higher beta, smaller biotech companies as they believe the sector is entering the 'equilibrium' stage of growth.

IBT also holds between 5-15% of the NAV of the portfolio in unquoted companies via venture funds managed by SV Health Investors. This provides additional exposure to early-stage drug discovery and the unquoted portfolio has also been a target for M&A activity, with the acquisition of Amwell, Healthify, Nordic and Nimbus.

Looking ahead, the long-awaited rate cut by the Fed could prove a tailwind for returns as the biotech sector has historically traded inversely with US interest rates. In addition, IBT is currently trading on a discount of c. 8% (which could provide a further kicker to returns if discounts narrow) in addition to a dividend yield of 4.7% (as at 28/05/2024).

However, Ailsa and Marek have shown their credentials in outperforming the index even in challenging times and the trust looks well-positioned to ride the strong secular growth drivers.

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