

## Biotech Growth Trust \*

Specialist – Biotech – Price 160.8p, Discount 6.0%, Market Cap £105m

- **Biotech Growth, which has been managed by OrbiMed since 2005, invests in both emerging and established Biotech companies, predominantly in the US. The fund has a solid record with the NAV up 72% since the change in management, compared with 60% for the benchmark, the Nasdaq Biotech index.**
- **The Biotechnology and Pharmaceutical sectors vastly out-performed the broader market in 2008 and provided positive absolute returns for UK based investors. However, both sectors have lagged since the market turned in early 2009, particularly on concerns over the impact from the Obama administration’s healthcare reform plans.**
- **Valuations appear reasonable and the long-term drivers of the sector remain intact. Contrary to expectations, the sector was not re-rated after the healthcare reform bill was passed earlier this year. However underlying companies continue to make substantial progress in terms of drug discovery, while M&A has continued to be a positive feature of the industry.**
- **In our view, this fund benefits from a specialist and well resourced management team with strong industry specific experience. For those who are looking for exposure to the Biotech market, we believe Biotech Growth provides attractive, well-managed exposure.**

### ■ Management & Investment Process

OrbiMed manages  
the portfolio

The investment portfolio of Biotech Growth Trust is managed by OrbiMed Advisors, the largest independent global specialist investor in biotechnology/pharmaceuticals with assets under management of around \$5bn. This New York based group has been responsible for the fund since 2005. The portfolio is managed by Geoffrey Hsu and Richard Klemm.

The investment process is research intensive, reflecting OrbiMed’s view that a focused portfolio of conviction stocks will lead to superior performance. Biotech Growth invests in both emerging companies with a market cap of less than US\$3bn that have undergone an IPO, but are as yet unprofitable, as well as the major Biotech companies which are larger and already generating profits.

*For more information about OrbiMed Advisors, and the fund’s investment process, please refer to Appendix I.*

### ■ Outlook for Biotech & Pharma

The long-term drivers of the Biotechnology and Pharmaceutical sectors appear to remain intact, including changing demographics, and growing middle classes in emerging markets. Other key, short-term drivers are detailed below;

- **US healthcare reform** – as a result of the healthcare reform package that was passed in March 2010 there will be some additional costs to be absorbed by Biotechs. However OrbiMed believes the benefits from having an additional 30 million Americans insured from 2014 should prove a net positive for the industry.
- **M&A activity** – M&A remains a key theme in the sector, with large pharma companies looking to supplement their R&D pipelines with new biotech products. M&A is one of OrbiMed’s key strategic focuses, and a number of holdings in the fund have been identified as possible targets for acquisition by big Pharma or large Biotechs. The fund benefitted from Genzyme, its second largest holding, being subject to a take-over offer from Sanofi-Aventis at a healthy premium.
- **Clinical data and regulatory decisions** – OrbiMed has noted that significant clinical data is due to be released in the next six months, which could prove a catalyst to sector. Furthermore, regulatory decisions are expected on a number of drugs which could have a similar effect.
- **Valuation levels** – despite there being greater clarity about the measures resulting from the healthcare reform bill, the sector has failed to be re-rated, and valuations remain at historically low levels.

Focus on undervalued large cap Biotech

### ■ Current Portfolio

The portfolio is focused on undervalued large cap biotech companies, growing pharmaceutical companies and smaller companies with significant growth prospects and/or the potential of acquisition. The portfolio currently has 31 holdings, with approximately 40% in major Biotechs, and the remainder in emerging biotech companies. This is in line with the fund's long-term target weightings. Exposure to major Biotechs was increased in 2008/09 as a result of the manager's cautious outlook on markets in general, however this has been rebalanced during 2010.

#### Top Ten Holdings

Company	Country	Market Cap (\$m)	% of Total Assets
Amgen	US	49,782	8.1
Genzyme	US	18,445	6.5
Gilead Sciences	US	29,633	5.7
Shire	UK	13,159	5.5
Cubist Pharmaceuticals	US	1,287	5.4
Celgene	US	27,947	5.1
Pharmacyclics	US	326	5.0
Human Genome Science	US	4,630	4.5
Endo Pharmaceuticals	US	4,162	4.0
BioMarin Pharmaceutical	US	2,776	4.0
<b>Total</b>			<b>53.8</b>

Source: The Company, Winterflood Securities as at 30 September 2010

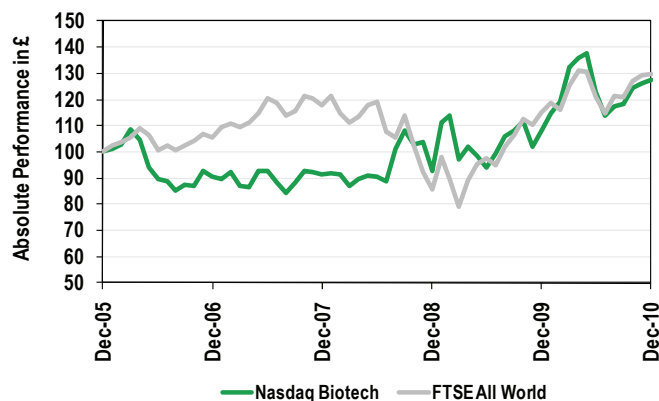
The fund has Board authority to borrow up to £15 million, and OrbiMed currently has a debt facility with Goldman Sachs. Given the recent volatility in the market however, OrbiMed has taken a more cautious approach and the fund currently is not geared.

### ■ Performance

Asset class has non-cyclical qualities

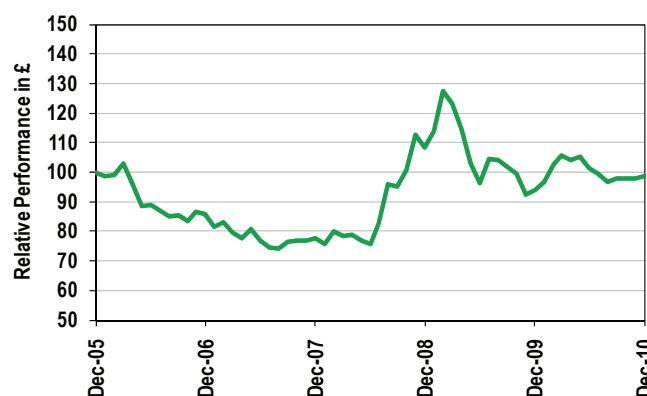
Having lagged the strong markets of 2004 to 2007; Biotech and Pharma bounced back in 2008 as a result of their less cyclical characteristics. Biotech was one of the few sectors to post positive absolute returns in 2008 (in Sterling terms). Despite Biotech having lagged since the market turned in early 2009, absolute performance has been solid. Over the last year the Nasdaq Biotech index is up 20% in Sterling terms, compared with 17% for the FTSE All World. UK investors in the sector have also benefitted considerably from Sterling weakness in recent years. With a vast majority of the biotech stocks listed in the US, foreign exchange movements have had a significant impact on returns.

Sterling based Absolute Performance over 5 Years



Source: Winterflood Securities, Thomson Reuters

Nasdaq Biotech relative to FTSE All World – 5 years

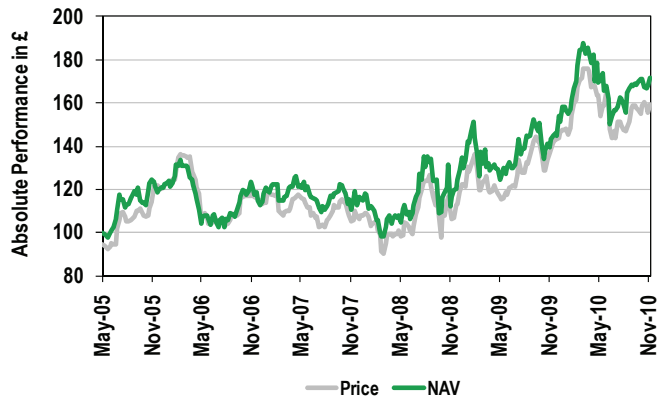


Source: Winterflood Securities, Thomson Reuters

Under OrbiMed management since 2005

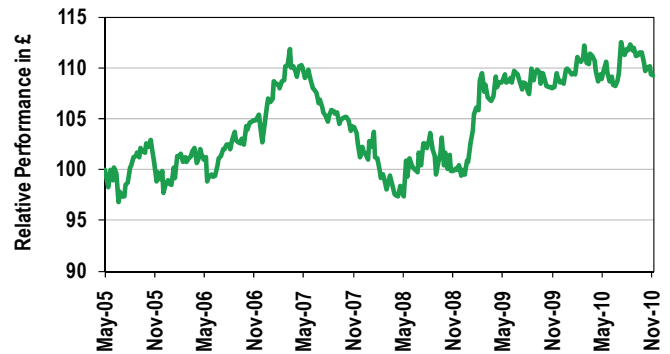
OrbiMed has managed Biotech Growth since May 2005, and in that time the fund's NAV is up 72% compared with 60% for the Nasdaq Biotech index. The fund outperformed its benchmark through 2005 and 2006, however it struggled in 2007, a result of its exposure to small cap Biotech companies. Performance was excellent through 2008 driven by the fund's defensive positioning, having increased the weighting to larger biotech companies. Over the last year, performance has been marginally behind the benchmark, with the NAV up 17%.

**Absolute Price & NAV Performance since May 2005**



Source: Winterflood Securities, Thomson Reuters

**NAV Performance Relative to Nasdaq Biotech since May 2005**



Source: Winterflood Securities, Thomson Reuters

**Discount History**

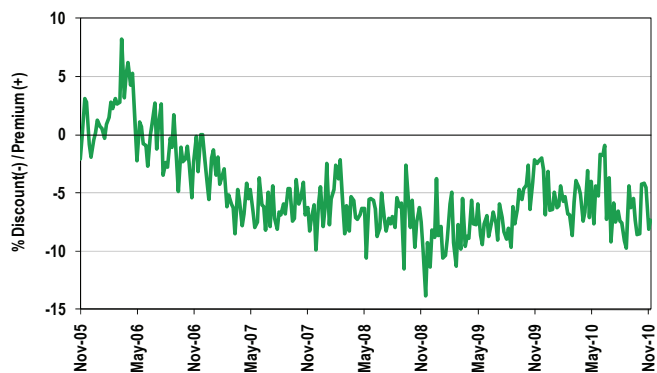
Discount is under-pinned

After OrbiMed took over as investment adviser, the fund was re-rated, and traded at a premium for a short time. However in the last 3 years the discount widened as the biotech sector lagged the broader market, and market conditions deteriorated. Although briefly trading at a tight discount in the last year, it has mostly traded in the range of 5-8% in recent years. The Board has made a commitment to support a discount of 6% through buybacks, and although few shares have been bought back in the last year, the fund has bought back nearly 25% of shares in issue since 2007.

£24m raised in 2009

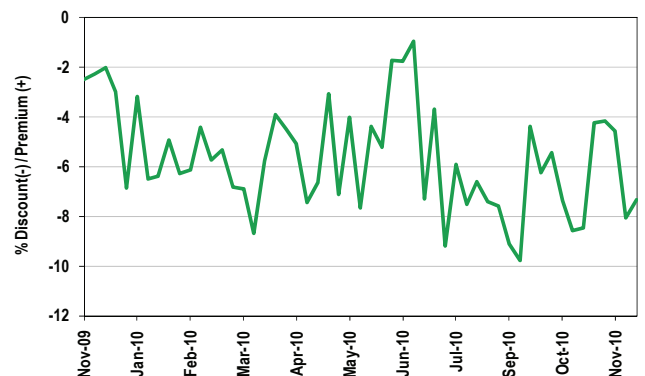
In December 2009, the fund raised £24m through a placing and offer for subscription. 16m new shares were issued at a price of 149.2p.

**5 Year Discount History**



Source: Winterflood Securities, Thomson Reuters

**1 Year Discount History**



Source: Winterflood Securities, Thomson Reuters

■ **Winterflood View**

Rerating has not happened

Many commentators predicted that Pharma and Biotech companies would be rerated following the passing of the Obama healthcare bill as the uncertainty overshadowing the sector was resolved. This did not happen. Furthermore, the result of the mid-term elections last month with the increased representation for Republicans has raised the prospect of changes to the reform. This is clearly a complicated area and in the short-term, the sector may suffer from a renewed bout of uncertainty. However, despite this, many of the underlying companies continue to make substantial progress in terms of drug discovery, while M&A has continued to be a positive feature of the industry.

Long-term drivers remain intact

As a sector, Biotechnology is not as cyclical as many and there will be times when its performance lags the wider market. However, the long-term drivers of Biotech are difficult to dispute. Despite short-term noise from factors such as the Obama healthcare reform, the long-term trend is strong. This sector can be difficult to value given the estimate of potential future earnings and there have been occasions when the sector has been overvalued. However, valuations currently appear reasonable and we suspect that, unlike other sectors such as **Resources** which have run hard in recent years, many investors will be under-weight Pharma and Biotech. For investors prepared to take a longer-term view, we believe that this presents an opportunity.

Experienced team

OrbiMed has a very experienced specialist team, which has produced excellent long-term results through its research driven approach. Biotech should be considered a higher risk, higher volatility proposition than general Pharma as a result of its research intensive, product development characteristics. For those who are comfortable with this risk profile, we believe this fund provides attractive, well-managed exposure to the Biotech market.

*\* The Biotech Growth Trust is a corporate broking client of Winterflood Securities*

## ■ Appendix I

### Management

OrbiMed remains as  
portfolio manager

Portfolio management is the responsibility of the investment adviser, OrbiMed Advisors, the largest independent specialist investor in biotechnology/pharmaceuticals with assets under management of around \$5bn. This New York based group was set up in 1989 and invests across the “life cycle” with its coverage extending from private equity through quoted biotech stocks to the big pharma. It is headed by Sam Isaly who is supported by a team of around 30 investment professionals, with extensive scientific, medical, finance and operational expertise.

The fund is managed by Geoffrey Hsu and Dr Richard Klemm. Mr Hsu joined OrbiMed in 2002 as a public biotechnology analyst. Prior to joining OrbiMed, he worked as a financial analyst in the healthcare investment banking group at Lehman Brothers. He holds an MBA from Harvard Business School, and prior to business school spent two years studying medicine at Harvard Medical School. Dr Klemm joined OrbiMed in 2000 as a public biotechnology analyst. He completed a Ph.D. from the Massachusetts Institute of Technology in Molecular Biology in 2000. He has published scientific articles in the fields of DNA replication and transcription. He received a B.A. from the University of California, Berkeley in 1994 with majors in molecular and cell biology and economics.

### Universe

The fund’s benchmark is the Nasdaq Biotech Index which includes approximately 130 US Biotech stocks. Biotech Growth Trust uses this benchmark to measure long term performance, and due to the weighting of the largest stocks in the index, needs to hold the largest members of the index to prevent excessive volatility. However it is not restricted to only holding stocks in the benchmark.

### Investment Process

Investment process is  
highly research  
intensive

The investment process is research intensive, reflecting OrbiMed’s view that a focused portfolio of conviction stocks will lead to superior performance. The universe is growing and now consists of several hundred quoted companies, the majority in the US, which are screened based on valuations and growth prospects. The remaining companies are actively followed by OrbiMed’s team of analysts who run valuation screens and meet management at least annually.

The focus is on those companies that have a catalyst for an investment thesis and the best ideas are selected to form a core list of around 30 to 40 stocks. This list will tend to consist of all the profitable companies (3-10% positions) and 20-30 emerging companies (1-5% positions). The fund will normally invest around 40% of its portfolio in the major cap Biotech companies, with the remainder in emerging Biotech.

The research emphasis depends on the nature of the company. The key characteristics they look for in Biotech companies are:

- management;
- innovative science; and
- sufficient resources to manage/fund growth.

OrbiMed typically looks to buy Biotech companies 2-3 years before profitability – they see profitability as an inflexion point with companies benefiting from improved liquidity and higher valuations, partly because many investors are only able to buy profitable companies.

OrbiMed will look to gain an “edge” over other investors through its scientific expertise, including the ability to predict the success of drug trials based on clinical data. OrbiMed uses its extensive medical and scientific experience to review results of clinical trials. Based on such analysis, they predict the success of future trials and ultimately the potential success of the drugs.