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Biotech Should Keep Rolling

The stocks look like good bets as most tech shares fade

By Ellen Licking
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Biotech stocks are a monster roller-coaster. News of a potential blockbuster drug or pending merger--or, conversely, bad results in a clinical trial--can make prices soar or plunge 15% or more in a day. For all their volatility, though, biotechs have racked up big gains this year. Can they continue to buck the tech decline?

Consider this: The AMEX Biotech Index is up 75.2% for the year, while the Nasdaq Composite Index is down nearly 30%. Biotech's day-to-day gyrations won't disappear: Bringing new therapeutics to market is, after all, a high-risk game. But analysts and fund managers expect the group to continue to outperform the market into 2001, because they consider biotech shares to be like pharmaceutical and other health-care equities--good defensive picks when markets turn bearish. No matter what the economy does, people need new and more powerful medicines, a demand that will likely increase as the population ages.

There are other reasons to be bullish. The biotech industry, experts say, is stronger than ever. "It comes down to the three P's: products, profits, and pipelines," says Michael D. Becker, author of a monthly Internet newsletter, Beck on Biotech. He notes that some 350 biotech drugs are now in human clinical trials, and more than 100 of them are close to coming to market. And at least 20 biotech companies are posting profits, compared with four just six years ago.

And the group has strong financing. Of the 300 publicly traded biotech outfits, analysts figure 194 have enough cash to weather an economic downturn. "This year alone, the industry raised \$40 billion--more than four times the record of just under \$9 billion [raised] in 1993," says Scott Morrison, Ernst & Young's national director of life sciences. Companies flush with cash include Immunex (IMNX), which raised an additional \$3.2 billion in November, and Human Genome Sciences Inc. (HGSI), which raised \$825 million in October. The market for initial public offerings has stayed open to biotech issuers, too. The most recent IPOs include Specialty Laboratories Inc. (SP) and Harvard Bioscience Inc. (HBIO)

Biotech companies fall broadly into three categories. Genomics companies are among the riskiest investments. These are early-stage companies, such as Celera Genomics Corp. (CRA) and Incyte Genomics (INCY), that sell patented genetic information and analytical tools to other biotech and pharmaceutical outfits. Then there are small-cap biotechs, such as Geron Corp. (GERN) and Cell Pathways Inc. (CLPA), that are struggling to turn novel technologies into new drugs. If they survive the arduous 12-to-15-year process required to turn an idea into a marketable product, these outfits could become huge successes. But the risks are enormous: Only one in 5,000 compounds actually makes it out of the lab and into the clinic.

GENOME TOOLMAKERS. The safest investments, however, are biotech's top-tier businesses. They have real profits, products on the market, and well-filled pipelines. Still, because of the inherent volatility of all biotechs, Faraz Naqvi, manager of Dresdner RCM Biotechnology Fund, cautions investors to put no more than 10% of their portfolio into biotech stocks and to hold them for at least three years.

Much of the recent buzz about biotech is due to the rise of genomics companies, which mine the human DNA sequence for information that might be turned into novel therapies. Many trade at frothy multiples of 25 to 30 times revenues. "[Although] many of these early-stage companies have great stories," Naqvi cautions, "that doesn't mean they have viable business models."

For investors who want to play genomics, Naqvi recommends "pick-and-shovel" outfits that develop the analytical tools that drug developers need to exploit the genome. "The advantage of these companies is that their revenues don't depend on getting drugs through risky clinical trials," Naqvi says. His top bets: Applied Biosystems Group (ABI) and Waters Corp. (WAT) Meanwhile, Robert J. Toth, an analyst at Prudential Securities Inc., likes Rosetta Inpharmatics Inc. (RSTA), which went public late this summer and is developing software programs to help genome researchers.

If genomics plays seem too risky, consider such biotech heavyweights as Amgen (AMGN), Genentech (DNA), Immunex, and Idec Pharmaceuticals (IDPH). These companies, which have products both on the market and in late-stage human testing, are also working with genomic data--and their prices have come down a good deal. Genentech Inc., for instance, is trading in the mid-70s, down from its March high of 122, despite the imminent launch of Xolair, a drug that Naqvi calls the "first asthma advance in 40 years." Xolair appears to prevent asthma symptoms, instead of lessening the effects of an attack once it's under way, as current medications do. Meanwhile, Chiron Corp. (CHIR), which is developing novel tests to diagnose AIDS and other infectious diseases, is trading at 44, not far from its 52-week low of 33.

Yet another good buy may be Amgen Inc., whose shares have remained flat since March. Reason: uncertainty about a patent-infringement suit that the company filed against a rival, Transkaryotic Therapies Inc. (TKTX) Patent experts and analysts widely believe that Amgen will come out on top. And the company is expected to launch several new drugs in

the next year and a half. In December, 1999, the company filed for Food & Drug Administration approval for Aranesp, a long-acting anemia drug. Next year, it's hoping to gain approval for two other biotech drugs, IL-1RA for rheumatoid arthritis, and Abarelix for prostate cancer. The company anticipates the markets for these three products could total more than \$6 billion. "If I had to recommend just one stock, it would be Amgen," says Daniel Gillespie, manager of the Rydex Biotechnology Fund.

PRACTICE DIVERSITY. The most cautious way to invest in biotech is through a diversified mutual fund. Naqvi's fund, for example, racked up a 26.7% return in the third quarter, highest of any fund in health care. And its return of 263.9% over the past year makes it the leading fund in any category. Naqvi tries to limit volatility by investing in as many as 60 different biotech outfits. His largest holding, Genentech, makes up less than 4% of his portfolio.

Even more diversified is Gillespie's Rydex fund. Although he owns such up-and-comers as Celera and Human Genome Sciences, most of his 75 holdings are established companies with products at least in late-stage human testing. His return so far this year is 34%. "Investors won't hit a home run" with his fund, Gillespie says. "But neither will they crash and burn if the sector gets spooked."

Even if the tech plunge eventually pulls biotech down, too, analysts believe the group is just beginning to flower. There's little doubt that novel medicines derived from the human genome will eventually transform the way medicine is practiced. Chosen wisely--and held for the long haul--biotech investments might transform your portfolio, too.