HBM Partners

Original published in Cash Online, May 2019

UNBRIDLED CAPACITY FOR INNOVATION

What are the biggest risks when investing in biotechnology, and what should investors take into consideration?

Cash. spoke to Dr Ivo Staijen, CFA, manager of the HBM Global Biotechnology Fund.

What are the biggest risks for biotech investors?
Staijen: First off, there are the risks associated with product approval and launch. Another risk that is becoming increasingly significant is that associated with insurance reimbursement. A drug must have a clearly positive cost/benefit profile for the health insurance companies to agree to reimburse it. Investments in individual stocks essentially pose increased risk, the level of which depends in part on what stage of development the company or its development products are at. Failures in clinical development are an inherent part of the process. So, it is not advisable for a private investor to invest in an early-phase company; that would be more like a bet. What is more, at least an elementary knowledge of medicine is crucial to investing successfully. This all means that a more diversified approach with an investment in a fund is more suitable for private investors.

In which areas of biotech are things changing fastest?
Staijen: The regulators, such as the US FDA, prefer innovative drugs that can alleviate or ideally cure a condition. Accelerated development and approval processes are available for particularly innovative drugs for severe pathologies. At the same time, the traditional pharma industry is becoming increasingly intertwined with biotechnology, which has become the backbone of innovation for the major pharmaceuticals companies. Immuno-oncology drugs are the best example of this. These all originate from the research laboratories of small biotech companies and have made their way into the pipelines of the majors via takeovers. Biotech companies need to have a clear focus on innovation. Niche strategies are often the most promising for survival amid the competition for innovation.

Which areas of the biotech industry hold the most promise?
Staijen: Gene and cell therapies are especially promising. Currently incurable, life-limiting genetic conditions can be treated with new cell and gene-based methods, and the drugs even hold out the promise of a cure – often requiring just a single treatment. These are illnesses which can be clearly attributed to mutations of a specific gene. Roche recently dipped its toes into this area by acquiring Spark Therapeutics, making it the fifth major pharmaceuticals group to do so, following in the footsteps of Novartis, Pfizer, Johnson & Johnson and Biogen. Smaller, independent companies such as Biomarin, Ultragenyx, UniQure and MeiraGTx also have potential drugs in the pipeline. New approaches in the field of oncology and also for illnesses affecting the central nervous system, cardiovascular conditions and auto-immune diseases all have potential too.

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Why should investors choose to invest in a biotechnology fund rather than a biotechnology index?
Staijen: Since mid-2015, shares in the major biotechnology companies have greatly underperformed small and medium-sized companies. The large biotech companies are in a similar position to large pharmaceuticals groups around ten years ago. They are facing expiring patents and slowing rates of sales growth for their existing products. Investing in the leading NASDAQ Biotechnology Index, which is weighted heavily towards biotech companies such as Gilead, Celgene and Amgen, carries the risk of missing out on the strong performance and in particular the promising return potential of the small and medium-sized segment (company value of between two and ten billion). The current environment is very different to that which prevailed between 2011 and 2015. Currently, there is a real advantage for specialist investors who can use a stock-picking approach to identify the most promising companies at an early stage. We assume this will remain the case for the foreseeable future.

What investment horizon should investors apply?
Staijen: Investing in the sector with a horizon of six to eight, maybe as long as ten, years is adequate. Major innovations come in cycles, and if you are around for long enough, you increase your chances of being there for the next cycle. And it will definitely come: there is unbridled capacity for innovation among small and mid-cap companies in particular. At the same time, there remains high demand for effective new drugs to treat unmet medical needs.

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