

Bio stocks on road to recovery

Small caps

Justin Bailey

B iotechnology stocks are attracting attention from investors seeking to take a punt on riskier plays. Many biotechnology companies suffered heavily throughout the downturn because of their unproved earnings potential. But since markets bounced, they have become a more attractive proposition.

Biotechnology companies develop products that can be used in the health, agricultural, environment and industrial sectors.

Before the financial crisis the Australian market was filled with overpriced public offerings of biotechnology companies.

But now investors have the ability to buy companies that have progressed much further with their research at similar prices.

Fund manager for Naos Asset Management Sebastian Evans thinks the biotechnology sector has a lot to offer investors, saying there are definitely four or five that have the chance to become billion-dollar companies.

One of the important dynamics driving the sector is the hunt by big pharmaceutical companies for new wonder drugs.

Pfizer, Roche and Eli Lilly are scouring the globe for new opportunities, with wonder drugs like Zoloft and Viagra coming off patent.

"A lot of the big-money drugs are coming off patent in the next few years, so a lot of their [big pharmaceutical companies] profitability going forward will be based around their new drug pipeline," Evans says.

"These companies can either do it themselves or acquire another product."

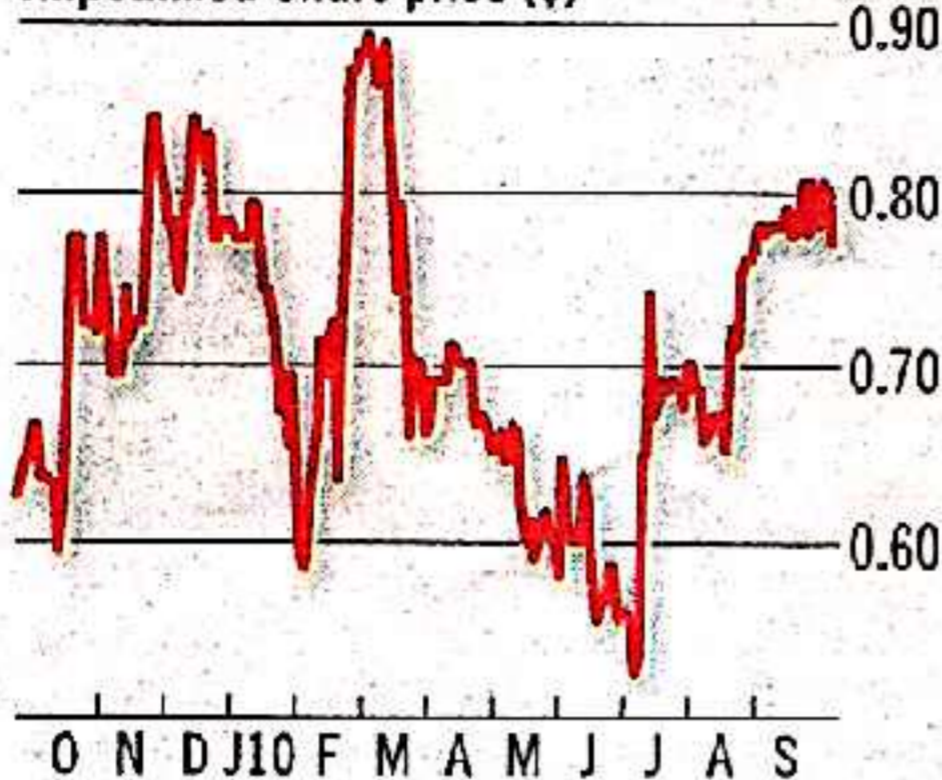
Biotechnology products typically advance through a number of stages. First, there is the lab where the drugs are developed.

The next stage is the clinic where drugs are tested, sometimes on animals.

If animal trials prove successful, the drug is trialled on a small-

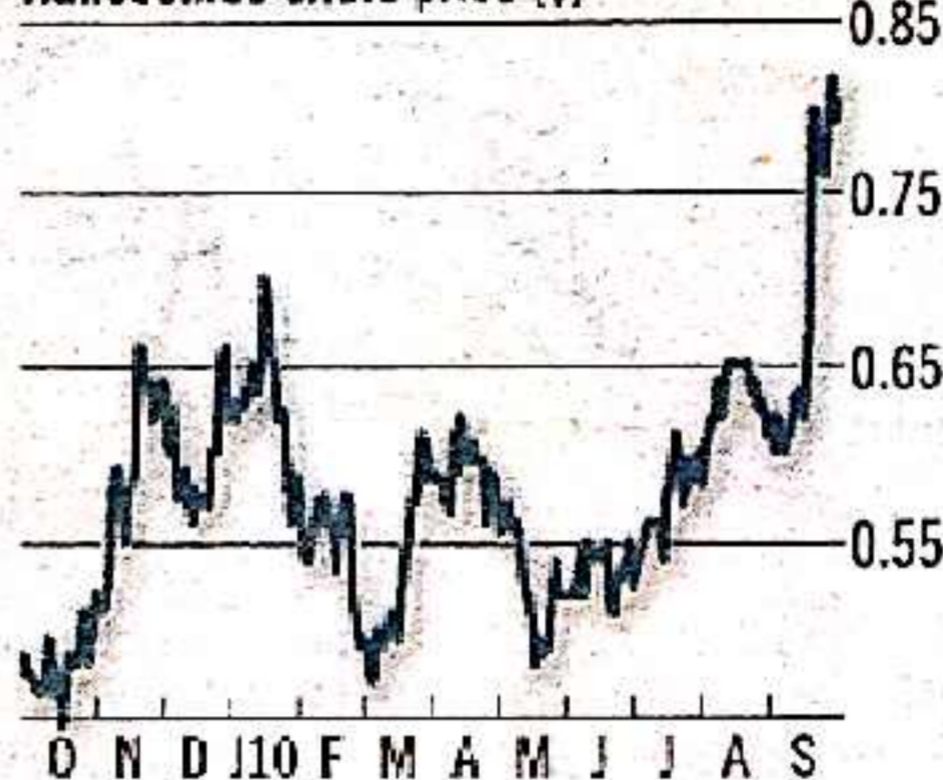
Innovators

ImpediMed Share price (\$)



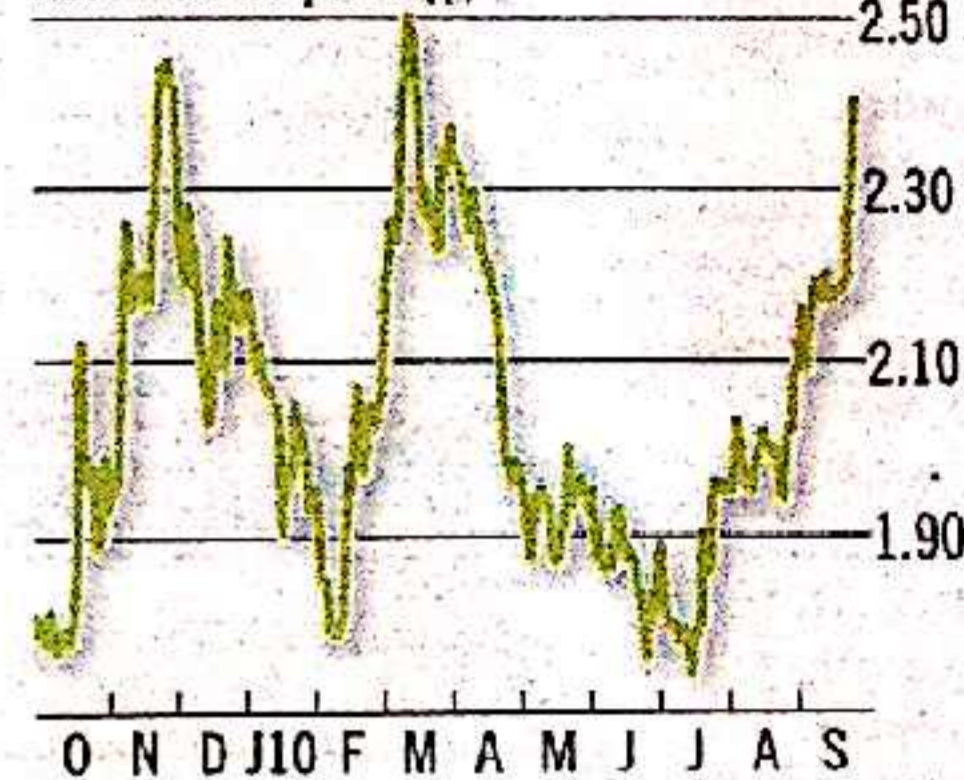
52-week high	\$0.90
52-week low	\$0.52
1-year return	23.4%
Forward EPS	n/a
Forward P/E	n/a
Dividend yield	n/a
YTD change	-0.4%

Nanosonics Share price (\$)



52-week high	\$0.87
52-week low	\$0.44
1-year return	64.9%
Forward EPS	n/a
Forward P/E	n/a
Dividend yield	n/a
YTD change	21.2%

Acrux Share price (\$)



52-week high	\$2.60
52-week low	\$1.70
1-year return	32.6%
Forward EPS	4¢
Forward P/E	5.5(x)
Dividend yield	n/a
YTD change	10.1%

SOURCE: BLOOMBERG

sample population, then a larger one, and finally the developer will seek approval from the US Food and Drug Administration (FDA).

Each stage becomes more expensive than the last, but so too do the chances of success. Evans says the key to investing in biotechnology stocks is understanding how they work.

"If you can't understand how it all works then there is no point in investing in it," he says.

"As soon as you get into drugs where you don't know how they will react to the human body it becomes a lot more risky.

"Everything in our portfolio is either phase 3 or waiting for approval from the FDA."

Three of his favourite stocks at the moment are ImpediMed, Nanosonics and Acrux.

ImpediMed develops bioimpedance devices that are used to help reduce the effects of lymphedema, a condition where limbs swell after an operation such as a mastectomy.

The products have a wide range of potential commercial applications, notably in the assessment and monitoring of

secondary lymphedema. The potential for the device is huge, says Evans, and there is no reason why the stock can't move to the mid-dollar mark during the next 12 months.

ImpediMed is also a favourite of the broking community. Of the two brokers that cover it, both say investors should buy it.

The company's 12-month consolidated analyst target price of \$1.11 implies a 44 per cent return in the next 12 months.

Nanosonics develops and commercialises a range of disinfection solutions.

The company is focused on the commercialisation of its launch product, the Trophon EPR, which is used to disinfect ultrasound probes and other devices.

The company has already received approval to sell the Trophon EPA in Europe and Australia and is now waiting for approval from the FDA.

Recently, giant American conglomerate General Electric agreed to distribute the company's products through its health arm.

The final hurdle for its product is FDA approval, which is expected

before year's end, and Evans suspects the stock could be at \$2 in just two to three years. The single broker that covers the stock has a "buy" rating on it.

The company's 12-month average analyst target price of \$1.52 implies a 90 per cent return during the next 12 months.

Acrux has developed a roll-on product that is used to help people with testosterone deficiencies. The roll-on goes under your arm and is arguably more effective than its gel-based rivals.

Its main rival, AndroGel, has a half-billion-dollar market in the US, which the company could tap into.

Eli Lilly likes prospects for the drug so much it has entered an exclusive worldwide agreement with the company for potential commercialisation of Acrux's experimental underarm testosterone solution.

Brokers also like the company. Three cover it and they all say that investors should buy it.

The company's 12-month average analyst target price of \$3.46 implies a 44 per cent return during the next 12 months.