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Bet On Big Biotech
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Shares of Amgen and Celgene can weather an economic storm.

DESPITE THE BIOTECHNOLOGY industry's reputation for risk and volatility, large-cap biotech stocks are no longer quite so risky, or expensive.

In fact, they can be had for reasonable multiples.

Sure, biotech stocks have fallen steeply off the record highs they posted in August, thanks to the stock market's recent blood bath. Despite a brief bounce last month, the AMEX Biotechnology Index remains 36% off its all-time record high on Aug. 14, according to Thomson Reuters.

At A Glance

Amgen (AMGN)

Stock Price: 55.99
52-Wk High: \$66.51
52-Wk Low: \$39.16
Market Cap: \$59.3 billion
Est. 2008 EPS: \$4.55
Fwd P/E: 12.2x
Est. Long-Term EPS Growth: * 9%
Est. ('08/'07) EPS Growth: 6%
Revenue (trailing 12 months): \$14.6 billion
Dividend Yield: none
CEO: Kevin W. Sharer
Headquarters: Thousand Oaks, Ca

Celgene (CELG)

Stock Price: 50.30
52-Wk High: \$77.39

52-Wk Low: \$41.26
Market Cap: \$23 billion
Est. 2008 EPS: \$1.55
Fwd P/E: 24.3x
Est. Long-Term EPS Growth: * 38%
Est. ('08/'07) EPS Growth: 47%
Revenue (trailing 12 months): \$2.3 billion
Dividend Yield: none
CEO: Sol J. Barer
Headquarters: Summit, NJ

* Based on analyst estimates looking ahead three to five years.

Sources: Thomson Reuters. But shares of large, profitable biotech companies have fared better than their small-cap peers, or the broader stock market for that matter. And with lots of cash and steady profit growth, two stocks in particular --- Amgen (AMGN) and Celgene (CELG) -- offer investors a compelling opportunity.

"The biggest companies will grow profits irrespective of what happens in the economy," says Evan McCulloch, manager of the Franklin Biotechnology Discovery Fund. "At a time when growth rates elsewhere are decelerating or turning negative, there is a sense of certainty with these companies."

Or as Will Muggia, chief investment officer at Westfield Capital Management, puts it, "(Big Biotech) are some of the only companies right now that I am confident will grow earnings year over year."

Patients with cancer, AIDS and rare genetic diseases can't afford to stop taking their meds. And while the credit crunch has left many small drug makers short on funds, big biotechnology companies already have several blockbusters on pharmacy shelves fueling strong and stable earnings.

In fact, profits from Big Biotech could climb as much as 15% to 20% annually for the next three to five years, says Steven Silver, an analyst with Standard & Poor's Equity Research.

And while shares of Amgen and Celgene still trade at premiums to the S&P 500 Index, their forward price-to-earnings multiples have contracted significantly, and now trade at or near five-year lows, according to Thomson Reuters.

"There are companies in this sector that are trading at multiples that do not reflect their earnings potential," says Jay Markowitz, analyst with T. Rowe Price Investment Services.

Affordable valuations and robust product lines have made some biotech companies acquisition targets. Eli Lilly & Co. recently grabbed cancer drug maker Imclone, while Swiss drug giant Roche is wooing Genentech.

Citigroup Global Markets recently cautioned investors that biotech stocks could face stiff headwinds, as the presence of a Democrat in the White House.

Yet big biotech companies still earn piles of money, an accomplishment in an industry where many companies haven't launched a drug or turned a profit.

For example, the Street expects Celgene to increase profits 47% in 2008.

Cancer drug maker Amgen, meanwhile, doesn't promise quite as much profit growth.

But at 12.2 times projected profits over the next four quarters, the stock trades at a 20% discount to biotech stocks tracked by Thomson Reuters, and is one of the least expensive big biotech names. Last week, Citigroup added it to the firm's list of "Top Picks."

Amgen has endured a string of disappointments, including safety issues that scuttled sales of its once popular anemia drugs and recent clinical trial setbacks. But the company is on the mend thanks to cost-cutting and promising new drugs, including promising experimental osteoporosis drug denosumab (see Weekday Trader, "Amgen Falls into the Bargain Bin," July 1, 2008).

Expected to hit the US market in 2009, the drug could eventually generate annual sales of up to \$2.5 billion, and could be Amgen's next blockbuster, says Franklin's McCulloch.

Last month, Amgen raised its financial forecasts for 2008, and now expects to earn between \$4.45 a share and \$4.55 a share. And Citigroup sees profits climbing an average of 11% annually between 2009 and 2012.

The biotech giant, meanwhile, has \$11 billion in debt. But with \$9.7 billion in cash on its balance sheet and free cash flow of \$5.4 billion, the company should be able to meet its debt obligations of \$4.5 billion by 2012, according to Citigroup.

"The debt is manageable," says S&P's Silver. "So they are well positioned to invest in their pipeline and acquire new assets."

Celgene, meanwhile, is Amgen's opposite in many ways.

The company focuses on drugs that treat blood and bone marrow cancers, including the blockbuster Revlimid (see Barron's, "From Bane to Blockbuster," February 25, 2008).

At 24.3x forward earnings, Celgene's valuation makes some folks jittery.

Still, Celgene is testing Revlimid on other blood diseases, including leukemia. And with profits expected to grow at an average rate of 38% annually over the next three to five years, Celgene has the fastest growing earnings per share compared to its large-cap peers, according to Thomson Reuters.

The company also has \$2.5 billion in cash on its balance sheet and no debt, says Westfield's Muggia.

Of course, biotech stocks are not risk-free.

Worsening unemployment could eventually hurt even AIDS and cancer drugs sales. Amgen and others could get hit by further improvement to the U.S. dollar. And legislation clearing the way for the development and sales of generic versions of biotechnology drugs in the US could get approved in 2009.

Several Big Pharma companies, meanwhile, are focusing more resources on developing drugs cancer and other diseases traditionally the territory of the biotech industries. And new drugs face a tough regulatory environment.

Still, with rising sales and steadily improving profits, Amgen and Celgene look healthy, despite the economy.

So, these stocks could be just what the research scientist ordered for investors willing to pay up a bit for returns.

Full Disclosure

- Citigroup Global Markets and/or one of its affiliates has acted as manager, or co-manager of an offering of securities of Amgen within the last 12 months, according to a research note published on November 21, 2008. Citigroup has a Buy rating on Amgen.
- Standard & Poor's Equity Research has a Buy rating on Amgen.
- Citigroup has a Buy rating on Celgene.
- Standard & Poor's Equity Research has a Strong Buy rating on Celgene.
- Westfield Capital Management held 5,012,476 shares of Celgene as of September 30, 2009, according to Streetsight.net.

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