Spotting Biotech's 2005 Stars

A topsy-turvy 2004 has paved the way for some potential opportunities for investors next year. Here are a half-dozen companies to watch.

The biotechnology industry was packed with highs and lows in 2004. The year started off with a bang, as the approval of two colon cancer treatments -- Genentech's (DNA) Avastin and ImClone's (IMCL) Erbitux -- boosted the sector. But the rest of the year was marked mostly by stumbles.

The departure of Mark McClellan as head of the Food & Drug Administration came in February. The U.S. Presidential campaign brought into focus the country's health-care woes. In the fall, the Chiron (CHIR) flu-vaccine debacle and Merck's (MRK) withdrawal of arthritis drug Vioxx cast a shadow over the entire drug industry. Also, the sales potential of expensive biotech treatments for cancer came into question. To boot, most of the sector's 35 initial public offerings of 2004 are trading well below their offering prices, and some have been major blowups.

BIG MOVERS. "With all of the positives and negatives, the industry had a pretty remarkable year," says Carl Feldbaum, president of Biotechnology Industry Organization, a trade lobbying association. Genentech in the earlier part of the year led a broad sector rally, and Biogen Idec (BIIB), with the approval of its potential blockbuster drug for multiple sclerosis, helped boost biotech stocks late in the year. The Amex Biotech Index will finish 2004 up about 10%, while the Nasdaq composite index will end with gains of less than 8%.

Analysts, by and large, are cautiously optimistic on biotechnology. A few negatives to watch: Possible lower reimbursement of new cancer drugs and intense competition for market share. Still, plenty of bright spots should get attention from the market: Updates on stem-cell research, new treatments for insomnia, and partnerships forged with struggling pharmaceutical giants should help lift sentiment on the industry.

So, which companies will help drive the biotech sector higher in 2005? Certainly, some get better marks than others. Here's a list of the stocks that are most worth watching.

**Biogen Idec (BIIB)**
This has been a stellar year for the Cambridge (Mass.) concern, and many analysts believe its stock still has more room to climb. So far in 2004, Biogen Idec has risen 81%, to $65, amid anticipation of the FDA's approval of Tysabri, a multiple-sclerosis treatment, which came in November.

Tysabri is expected to be a hit, but "the opportunity is larger than what people think," says Ilya Kravets, analyst at Mehta Partners. Biogen Idec will soon release late-stage data on Tysabri's use in psoriasis. And an advanced trial for Crohn's disease, a gastrointestinal disorder, will be unveiled in the middle of 2005.

Most analysts, including Kravets, figure the stock is priced appropriately but will continue to climb if Tysabri proves useful for other conditions. SG Cowen's Eric Schmidt calls Biogen Idec "one of the industry's best long-term growth stories."

**Genzyme General (GENZ)**
The Cambridge (Mass.) outfit has made its fortune in treatments for rare genetic disorders. Some aggressive acquisitions have helped it broaden its scope to other disease areas in recent years, says Weidong Huang, vice-president at TimesSquare Asset Management. Genzyme recently completed its $1 billion purchase of Illex Oncology, which develops cancer drugs. An FDA panel in December said Illex's experimental treatment clofarabine for pediatric leukemia was "approvable." If the agency O.K.'s it by Dec. 30, Huang expects the drug to also get a lot of use in the adult leukemia market.

"People think the drug will be a $100 million or below [in annual sales], but I think it's on the order of hundreds of
millions," says Huang. Genzyme currently trades at about $56.11, near a 52-week high. But Huang sees continued upside as clofarabine reaches the market in 2005.

**Gilead Sciences (GILD)**
The Foster City (Calif.) company is among a handful of large, profitable biotechs. But it's still less appreciated than its better-known peers Amgen (AMGN) and Genentech. Gilead trades at $36, or a price-to-earnings-to-growth ratio of 1.3, says Kravets, while Biogen Idec's ratio is 1.8. Yet 2005 will likely be an impressive year for Gilead, which is in late-stage studies of a combination pill of its Viread and Emtriva antiviral drugs for HIV. Mehta Partners' Kravets says Gilead's combo drug will be filed with the FDA before the end of 2005, and it's likely reach the market in 2006. Kravets has a $40 price target on Gilead.

**Rigel Pharmaceuticals (RIGL)**
Rigel is attractive to many investors, as it may have a potential blockbuster on its hands. Its asthma and allergy product R112 is the first of its kind and seems to work better and faster than antihistamines.

Now, the South San Francisco-based pharma must meet its next challenge: Find a large drug company partner to help develop and market the treatment. Analysts expect an agreement will be inked in early 2005. Novartis (NVS) is most likely to partner with the company, figures Huang. Kravets agrees and predicts that the deal could be "bigger than expected." Rigel now trades at about $24.28, but Kravets thinks it could rise as high as $44 over the next year.

**Biocryst (BCRX)**
For this Birmingham (Ala.) outfit, 2004 was a forgettable year. Its leukemia drug forodesine, now in Phase 2 testing, has shown a good side-effect profile, but Biocryst's stock lost momentum midway through 2004, amid a broader sell-off in smaller biotechs.

Biocryst is a high-risk play with only about one year's worth of cash left in its coffers. But it hopes the FDA will grant forodesine accelerated review status in 2005, and "there's potential for partnership with a drug company, if data are compelling," says Ren Benjamin, senior analyst at Rodman & Renshaw. Biocryst trades at about $5.77, but it could rise to $10 in 2005, says Benjamin.

**Chiron (CHIR)**
Shares have fallen by a third since the Emeryville (Calif.) flu-vaccine maker announced manufacturing problems this fall. Geoff Porges, an analyst at Bernstein Research, figures Chiron's various businesses are worth a total of $32.90 per share. That number is just above its current trading price of $31, suggesting "that the market has largely factored in the prospect that Chiron will not return to fluvirin production in 2005," writes Porges in a recent report.

Chiron's woes will likely worsen before they improve, but "the stock appears to be near its bottom and will warrant consideration in the near term," according to Porges, who views Chiron as a longer-term turnaround story.

In the coming year, as exciting areas of biotech research advance, investors will have no shortage of opportunities. And at least some of the companies profiled here are sure to be among them.

---

Tsao is a reporter for BusinessWeek Online in New York

Edited by Patricia O'Connell