WEEKDAY TRADER

Gilead Way Oversold as Investors Flee Biotech

BioMarin also a bargain. The sector is now selling at a price/earnings to growth ratio of just 0.5.

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Buying when everyone else is scared is a time-honored means of snapping up good stocks really cheap. Right now, investors with the stomach to go against the crowd should consider the biotechnology sector.

After half a decade of eye-popping returns, biotech stocks, as a group, have been among the worst performing industries in the Standard & Poor's 500. The SPDR S&P Biotech exchange-traded fund (ticker: XBI) and the iShares Nasdaq Biotechnology ETF (IBB) are both deep in bear market territory, having dropped 50% and 39%, respectively, since their summer peaks.

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But as stock prices have dropped, so have valuations, down to levels not seen in years. Investors willing to weather the industry's volatility can snap up shares of established players with successful drugs that are able to drive future growth via their pipelines or acquisitions.

"It's like going to the department store where everything is on sale," says Paul Yook, a portfolio manager for the BioShares Biotechnology Products ETF (BBP).

Our picks: Gilead Sciences (GILD) and BioMarin Pharmaceutical (BMRN). Down sharply from last summer's triple-digit share prices, both stocks fetch valuations well below recent highs. In fact, Gilead has rarely traded so cheaply, with a single-digit price-to-earnings multiple that's among the lowest in the S&P 500. BioMarin, meanwhile, offers robust growth at a bargain, with sales growing at a double-digit clip not reflected in its current valuation.

That's not to say that we're calling a bottom on either stock, or the broader biotech industry, a near impossible feat in such a capricious market. Risk-averse investors turned their back on biotech amid global turmoil last summer, and then dumped shares again recently. Politicians have opened fire on high drug prices, partially in response to Martin Shkreli's price-hike antics.

5 Cheap Biotech Stocks

The Nasdaq Biotech Index has fallen 40% since last summer. Here are a handful of companies that look too cheap.

Company/Ticker	Price	6-Mo. Price Change	What's to Like
Gilead / GILD	$87.36	-50.8%	Gilead, trading at 7.2 times earnings, is hunting for an acquisition, repurchasing stock, and yields 2%.
BioMarin / BMRN	$67.26	-22.6%	Analysts expect BioMarin to more than double revenue by 2020.
Celgene / CELG	$99.59	-24%	A robust pipeline and smart deal making could help fuel 22% average annual profit growth.
Biogen / BIIB	$245.11	-51%	With a P/E of 13.5, Biogen is rarely this cheap. Efforts to bolster sales of the MS drug Tecfidera appear to be working, and company has $6 billion in cash.
Anacor / ANAC	$68.57	-24.8%	Big hopes rest with an experimental skin drug that could receive FDA approval this year.

Sources: Thomson Reuters; Yahoo! Finance

More recently, there's been a dearth of great product launches, a slowdown in headline-grabbing clinical trial data, and some big gaffs and disappointments.

But valuations are just too cheap to ignore. Biotechnology stocks tracked by Thomson Reuters at one point traded at 26.5 times earnings estimates, as a group. Today, that basket sells for less than 12 times earnings, a bargain-bin level given that Wall Street forecasts industry profits will grow an average of 23% annually over the next five years.

That puts the industry's price/earnings to growth (PEG) ratio at 0.5, suggesting that investors can get that growth at a 50% discount.

"Nothing fundamental has changed in biotech," says Cowen analyst Phil Nadeau. "Earnings growth and pipelines are as full as ever. If you want growth and you're comfortable with the risk, you want biotech in your portfolio."

Even after falling 55% since summer, BioMarin looks expensive compared with many of its peers. At 9.3 times 2016 sales, the drug maker trades at twice the valuation of the broader industry. But BioMarin's growth rate is far from average: Analysts forecast annual sales growth averaging 25% for the next several years.

BioMarin makes therapies for rare diseases, an enormously profitable market. The company already markets five commercial products that could generate revenue totaling $1.1 billion this year. By 2020, its top line could reach $2.8 billion, with 42% of that revenue from drugs not yet on the market, according to Credit Suisse, one of several firms that recently included the company on a list of biotech stocks to buy in 2016.

Gilead, by comparison, is a straight-up value play. Down 30% off a high $123.37 in June, the maker of HIV drugs is the cheapest biotech stock in the S&P 500, trading at 7.2 times 2016 earnings.

The stock's pullback began before the biotech bust last year amid worries about slowing sales of its blockbuster hepatitis C drugs, which generate roughly half of its revenue. But as *Barron's* recently pointed out, Gilead has beaten Wall Street earnings estimates during each of the past four quarters. The company is shopping for deals to add a new growth engine and has the cash to make a big purchase. It is aggressively buying back stock, recently committing $12 billion on top of the $15 billion buyback approved last year. Gilead is also one of the rare biotech companies paying a dividend, yielding more than 2%.

"It is trading like a broken-down growth stock, but at the price you're paying, you don't need big expectations for this stock to work well," says Tony Scherrer, an analyst at Smead Capital Management.

Not everyone agrees. Critics argue that Gilead needs to unveil details regarding how it plans to grow before the stock can generate sustainable gains. Yet they may have to wait a bit, as CEO John Martin, who ran Gilead for the past decade and grew it from a $1 billion market value to the current $126 billion, is relinquishing his post as the company's top executive to assume the role of executive chairman.

Meanwhile, Alessandro Valentini, a portfolio manager at Causeway Capital Management, worries that recent setbacks at Regeneron Pharmaceuticals (REGN), Vertex Pharmaceuticals (VRTX), Incyte (INCY), Celgene (CELG) and other companies suggest that there are "cracks in the biotech investment thesis….Valuations in biotech are a lot more interesting but they aren't there yet."

For many companies, however, the rewards outweigh the risks. Or as BioShares' Yook puts it, "Yes, prices can always fall lower, and it is impossible to call a bottom to things, but when I look at where stocks are trading now, I feel strongly that investors buying at these levels, who can wait it out, can make very good returns."

Full Disclosure

• Credit Suisse and/or one of its affiliates intends to see compensation from BioMarin Pharmaceutical in the next three months for investment-banking services. The firm has an Outperform rating on the stock.

• Smead Capital Management held 805,998 shares of Gilead Sciences as of Dec. 31, 2015, according to filings.

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