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Follow 2 geniuses into drug stocks

These little-known money managers -- and brothers -- have come up big by buying into cutting-edge biotech companies that are essentially recession-proof. Here are five of their picks.

By [Michael Brush](#)

In times like these, it's a good idea to focus on companies that can't get waylaid by a recession.

Go with those that produce things many people will have absolutely no choice but to use sooner or later -- like treatments for cancer or diabetes, or diagnostic tests that might help them avoid chemotherapy.

My MSN Money colleague Jon Markman likes to warn that the biotechnology field is full of profitless companies and promising drugs that never reach market. So how do you know which ones to choose?

I turn to two tenacious brothers with a proven record of finding huge biotech winners: the Baker brothers.

Expertise on record

Haven't heard of Julian and Felix Baker? I'm not surprised. Other than the occasional interview in The New York Times and marriage notices, these New York money managers don't appear much in the press. You won't see them on CNBC. They didn't respond to my inquiries for this article.

But their prowess comes through loud and clear if you dig through the records:

- Shares of **Seattle Genetics** ([SGEN](#), [news](#), [msgs](#)) have gone up 40%, on average, six months after they were purchased by one Baker brothers fund in recent years, according to Thomson Financial. The brothers are up 93% on Seattle Genetics shares purchased in the past 18 months.
- Shares of **Incyte** ([INCY](#), [news](#), [msgs](#)), **Genomic Health** ([GHDX](#), [news](#), [msgs](#)) and **ViroPharma** ([VPHM](#), [news](#), [msgs](#)) have advanced 40% to 66% after being purchased by Baker funds in recent years, Thomson says.

The brothers have some losers, too. But their record is downright impressive.

"They tend to buy at lows," says Michael Panichaud of Market Profile Theorems, an independent adviser whose own picks handily beat **S&P 500 Index** ([\\$INX](#)) returns. "They define an area of relative attractiveness and are persistent in their accumulation. Over the longer term, their bets are vindicated."

You can't buy shares in any mutual fund run by these two geniuses. They manage money for universities and foundations through a firm called Baker Bros. Advisors, which they founded in 2000 after years of managing money for the family of former CBS television chief Laurence Tisch.

But through public filings, you can see what they've been buying lately and perhaps follow along. Five that look attractive are Seattle Genetics, Genomic Health, ViroPharma, Incyte and **Allos Therapeutics** ([ALTH](#), [news](#), [msgs](#)). (Warning: This column may drive up prices temporarily, so don't buy these stocks for more than what the brothers paid. Don't lose money to a spike.)

Behind the success

What makes the Baker brothers so special? Biotech leaders paint the following picture:

First, they are really smart. "Felix is almost like an encyclopedia of knowledge," says Clay Siegall, the chief of Seattle Genetics. Felix earned a doctorate in immunology from Stanford University after studying biology there as an undergrad. Julian, who studied at Harvard, has a business background.

Next, they put in long hours to understand what they invest in. "They do their homework just about as well as anyone I have met from the Wall Street community," says Genomic Health chief Randy Scott. "They are very intense."

Scott recalls how, years ago, Julian listened for 45 minutes to his presentation on Incyte, a company he was setting up at the time. Julian excused himself to pull his brother from Stanford's nearby campus. Both finished the meeting and later invested heavily in the company.

- The Bakers work well in teams, both as brothers and with colleagues. "When we meet with them it is never only one or two people," says ViroPharma chief Michel de Rosen. "Sometimes it is four or five or six people, and they all take notes."

These managers praise the Baker brothers for their long-term perspective as shareholders and their connections in both the scientific and financial worlds. In at least one case, they helped persuade a large mutual fund to take a position in a stock they held.

Seattle Genetics

Seattle Genetics makes antibodies that attach to cancer tumors and instruct them to die. They also make antibodies on steroids, packing a lethal dose of toxins. "We attach a potent cell-killing agent that stops cancer cells from dividing," Seattle Genetics' Siegall says.

These superantibodies are based on the company's antibody-drug-conjugate (ADC) technology. Seattle Genetics licenses the technology to other drug companies, including **Bayer** ([BAYZF](#), [news](#), [msgs](#)) and MedImmune, a division of **AstraZeneca** ([AZN](#), [news](#), [msgs](#)). It also gets income from a partnership with **Genentech** ([DNA](#), [news](#), [msgs](#)).

Seattle Genetics might not have products on the market until 2011. But it will present findings in the meantime at medical conferences, and those should move the stock. It expects to end the year with more than \$160 million in cash while spending as much as \$65 million on research and operating costs.

Needham & Co. analyst Mark Monane describes Seattle Genetics as a "rising star" among companies looking blood-cancer treatments. He has a \$15-a-share price target on the stock.

The Baker brothers' position: They've owned the stock for years. They also purchased \$25 million worth of the stock on Jan. 23 at \$8.99. They now own 13.1 million shares, or 16.5% of shares outstanding. Felix Baker leads the board of directors.

Genomic Health

Chemotherapy is incredibly clumsy. The treatment also kills healthy cells, which can create serious problems.

But chemo is like a shotgun in another sense: Only a small portion of patients who get chemo actually need it. Out of a group of 100 patients with breast cancer that hasn't spread to the lymph nodes, for example, only four will actually benefit from chemo. But doctors can't tell who, so they have to put too many through the ordeal.

Now that's changing. Doctors can use a test from Genomic Health that can determine which breast-cancer patients will be helped by chemo. Patients like the test for obvious reasons. Insurers like it because the test, called Oncotype DX, can save the \$30,000 or so that chemo costs per patient.

This helps explain why sales have been growing rapidly. The company expects sales to nearly double next year to as much as \$110 million, driven mainly by higher interest in the Oncotype DX test.

A similar test to be used on people with colon cancer could arrive next year. Tests for people with other cancers may follow. "We are really changing the treatment paradigm," Genomic Health's Scott says.

The Baker brothers' position: They were big buyers in 2005 and 2006 in the \$12-to-\$14 range, and they were steady buyers last year on weakness in the \$15.50-to-\$18.50 range. They have bought as high as \$21.50, and they own 5 million shares, or 17.4% of shares outstanding. Julian Baker is a company director.

ViroPharma

ViroPharma is a rarity in biotech. It has shown profits and positive cash flow for 11 quarters in a row. The company generates revenue by selling a potent antibiotic called Vancocin, which is used to treat serious intestinal-tract infections.

Chris Armbruster of AI Frank Asset Management thinks it's a smart strategy to fund research by selling a profitable drug because it means the company is unlikely to issue more stock, which can hurt shareholders. His firm owns the stock in part because it looks cheap, and it has \$4.33 per share in cash after debt.

It has a drug in late-stage testing that could prevent the flare-up of a virus in people whose immune systems have been suppressed to keep them from rejecting transplanted organs. Known as Camvia, the drug has potential annual sales of \$400 million to \$500 million, says ViroPharma chief Michel de Rosen.

The company is collaborating with **Wyeth** ([WYE](#), [news](#), [msgs](#)) on a treatment for hepatitis C and is developing a drug called NTCD to be used with Vancocin to treat intestinal infections.

The Baker brothers' position: They have plowed \$11 million into the stock since November, buying in the \$7.50-to-\$8.80 range. They recently owned 9.9 million shares, or 14% of the stock.

Incyte

Incyte's pipeline includes drugs for cancer, diabetes, HIV, and inflammatory diseases such as multiple sclerosis and rheumatoid arthritis.

The most promising drug near term may be one that inhibits enzymes that help transmit signals in the body that are crucial in the development of diseases. It recently showed promise in treating people with a bone-marrow disorder called myelofibrosis, which disrupts blood-cell production.

Enzyme inhibitors may also be used to treat cancers and other diseases. Incyte has a partnership with **Pfizer** ([PFE](#), [news](#), [msgs](#)) to develop another drug for use against inflammatory diseases like rheumatoid arthritis. Banc of America Securities analyst Katherine Kim has a \$15 price target on the stock.

The Baker brothers' position: They were big buyers in 2003 for around \$5 and in 2007 for \$8 to \$9. In January, they put \$17.1 million into the stock. They now own 12.6 million shares, or 14.9% of shares outstanding. Julian Baker is a director.

Allos Therapeutics

Allos Therapeutics' main drug, pralatrexate (PDX), has produced impressive results in early testing against T-cell lymphoma, a kind of blood cancer. The success rate was so high that approval looks like a slam-dunk. The drug interferes with compounds used by tumor cells to divide.

The company thinks it might get approval for use of the drug against the rare blood cancer by mid-2009. Banc of America Securities' Kim believes that annual sales could hit \$250 million by 2013.

But the potential is much bigger because the company is testing PDX for use against lung cancer and another kind of cancer. Allos owns PDX outright, a rarity for a small biotech company. Kim has an \$11 price target on the stock, which recently traded for about \$7.

The Baker brothers' position: In January, they put \$5.2 million into the stock at \$7 to \$7.50 per share, taking their position up to 6.5 million shares, or 9.7% of the company.

If you plan to follow the Baker brothers, just be warned that not all their picks work out, at least in the short term. Last summer, filings revealed they owned 7.5 million shares of **BioCryst Pharmaceuticals** ([BCRX](#), [news](#), [msgs](#)). Since then, the stock has fallen 50%.

They are long-term investors, so this position could still bring profits. On the other hand, they haven't been buying more in the weakness, at least not according to public filings.