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# Xoma: A Lower Risk Way Of Investing In Biotech

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Biotech stocks have been big winners this year. But since individual biotech stocks can lose 50% in a single day, readers have asked if there is a "safer" way to invest. Bruce Pile tells us about Ligand Pharmaceuticals and Xoma Corp., two biotechs that do not bet the whole company on a single drug candidate.

*Ed Note: Xoma is a micro-cap stock. Micro-caps tend to be more volatile and in the past have been more susceptible to market manipulation. Investors should proceed with caution.*

**Ken Kam:** After a down couple of years, biotech has regained market favor. What's up with biotech?

**Bruce Pile:** There is a genetic revolution going on that I wrote about in 2015 in "Insider Wisdom And The New Medicine." After the global Human Genome Project was completed in 2003, there was a digestion period of seven years. Then the IBB index took off with a five fold rise from 2010 to 2015. It seems to be re-energizing after a two year lull.

**Kam**: But people don't want to invest in something that can lose 50% of its value in one day. Is there a way to invest in biotech without taking such large risks?

**Pile:** The genetic developers are typically tiny upstart companies run by science people into a sea of red ink to put drugs through trials for FDA approval. But only about one in ten ever get approved and the casualty rate is high. You can own stock in the big pharmas that are collaborating with the more promising candidates of the small caps, but you would likely be better off with an ETF.

**Kam:** We have explored Biotech ETFs in "Is A Biotech Index Fund A Safer Way To Invest In Biotech," is there a better return option?

**Pile:** There is another moderated risk choice now developing. The "Ligand model" is what it›s often called and Ligand Pharmaceuticals was the first to decisively go down this road. A *Forbes* article from 2015 details this. Up until 2008, Ligand had been swinging the trials bat with no earnings home runs to show for it. As the *Forbes* piece relates:

"On his first day as chief executive ... John Higgins was shown into a conference room ... Inside was a table so mammoth, Higgins recalls, "you could practically land a corporate jet on it." The new CEO immediately instructed the head of facilities to find a carpenter and cut it up into smaller tables ... He was a hit man, brought in amid a raid by activist Dan Loeb of Third Point LLC to stem the losses at the once promising biotech firm and turn whatever was left into quick cash.

He started by slashing the workforce from 365 down to around 20, where it is today. You could say he turned Ligand into the Wal-Mart of biotech. He proceeded to "farm out" the prospects to the big companies with royalty agreements, milestone payments on successful trials, and other high volume, less risky, but less than home-run reward.

**Kam:** How has this approach worked for Ligand?

**Pile:** It has been extremely successful. The stock has swooned from a speculative $140 in 2004 to $8 in 2010, when the Higgins plan took hold. It's now a cash flow rich $145. As the *Forbes* article summed it up, "No question Higgins has wrung the romance of biotech right out of Ligand." But he has certainly dialed in the profits.

**Kam:** It seems a little late to invest in the turn-around at Ligand.

**Pile:** We have missed the train on Ligand. But there is another train boarding —

Xoma Corp. (XOMA). About three years after Higgins started at Ligand, Xoma began adopting this same business model. But they didn't decisively ditch the old model until 2015, when disaster struck.

A failed phase III endpoint smashed the stock from $100 to the mid-teens. The stock has been in this doghouse ever since — until now. The model switch is drawing some attention as seen by the massive upgrade in *Barron's* in September:

"We are upgrading our rating on Xoma to Outperform from Neutral and increasing our 12 month price target to $19 from $9. We drew a line in the sand requiring a deal to validate the new business model of lean operating expenses and licensing revenues and Xoma (ticker XOMA) delivered

The similarity between XOMA and Ligand is being noticed by biotech pundits, but Xoma has a long hill to climb to be as successful with this as Ligand.

However, if they continue to progress, they will inevitably command the kind of "royalty premium" that Ligand now enjoys — a five year average multiple on its revenue of 22! Adjusting Xoma's current 4 multiple to Ligand's current 27 implies another six fold increase in stock price, not even counting future revenue growth.

**Kam:** So what has Xoma been saying about all this?

**Pile:** Well, Xoma reported their quarter Nov. 6 and it was a massive beat. As for their press releases, I find the one from Oct. 4 very interesting, "XOMA Announces Multiple New License Agreements For Proprietary Phage Display Libraries."

Phage displays are cataloged genetic antibody configurations that can be "looked up" to match the profile of a specific disorder being worked on with the new immunotherapies — arming the body's own immune system with super weapons. The US National Library of medicine has a section called "Phage Display — A Powerful Technique For Immunotherapy."

Xoma is becoming a major trafficker in phage display, claiming in the press release, "XOMA's premier antibody discovery platform includes three phage display libraries, which are among the largest in the world."

**My Take**: Bruce started his Marketocracy fund in January, 2001. Until this year, Bruce had been outperforming the market for the previous 16 years. As we have seen time and time again, no investment style performs well all the time. Because of his long-term track record, I have confidence that Bruce will get his performance back on track and his investment ideas are well worth considering. Before taking anyone's investment advice, you should always check out their track record. Here's Bruce's.

For those who are learning to invest, its a good idea to hone your investment style without putting your assets at risk by managing a Marketocracy model portfolio. Learning to invest, like learning to play the piano, involves making lots of mistakes. How many great pianists would there be if every time a student made mistake it cost $1000. Before Marketocracy, the only people who could afford to make enough mistakes to become great investors, are those who were investing other people's money.

*I believe people should have to prove themselves before they can manage other people's money and the best evidence of investment skill is a track record. For more information contact me.*

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