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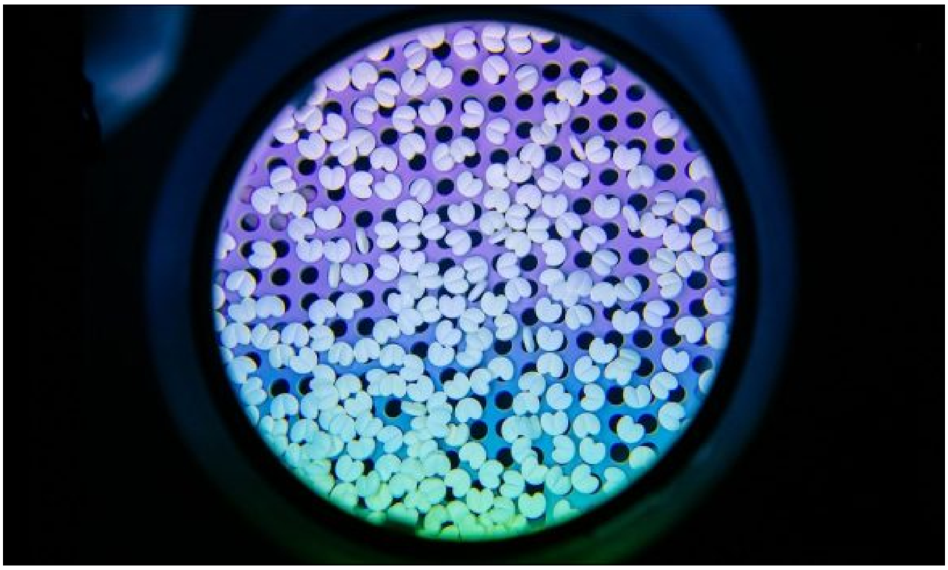
PATIENT CAPITAL TRUST INTERIM RESULTS

Mitchell Fraser-Jones, 4 August 2016

The views expressed in this article are those of the author at the date of publication and not necessarily those of Woodford Investment Management Ltd.



Today sees the release of the Woodford Patient Capital Trust's interim results. You can find a copy of the report here, and we have published Neil's portfolio manager's review below.

To coincide with today's interim results we have also, as part of our transparency initiative, published for the first time the transaction costs incurred in the management of the trust. Performance data has also been incorporated into the Trust facts page for the first time. Both of these pages will be updated monthly from now on.

Update from Neil on the trust's progress and outlook

Manager's review from Neil Woodford

It's been a tough start to the year for financial markets and for the Woodford Patient Capital Trust portfolio in particular, but considerable progress has been made across much of the portfolio.

Sentiment towards the health care sector has remained negative throughout the period under review. This was particularly the case in the US, where election concerns and Hillary Clinton's adverse rhetoric on drug pricing have in part prompted a prolonged and significant correction. Having enjoyed several years of very strong returns, the Nasdaq Biotechnology Index, for example, has declined more than 40 per cent from its peak in July 2015. Less than 16 per cent of the portfolio's assets are invested directly in US-listed biotechnology companies, but these negative trading conditions had a significant influence on health care shares on this side of the Atlantic too.

Performance

Despite considerable progress across much of the portfolio, the Company's net asset value declined by 10.8 per cent in an investment environment that was very challenging for the share prices of early-stage businesses. Importantly, in most instances, this share price behaviour is not in any way linked to a deterioration in individual company fundamentals. It has, however, had a detrimental impact on the share prices of some of the businesses in which we have invested and, in turn, the net asset value of the trust overall.

A clear exception here is Circassia, which announced data from a high-profile phase III trial into its cat allergy vaccine. Although many aspects of the trial data were highly encouraging, further evidencing the drug's strong therapeutic benefits, the latest results also showed that a placebo had broadly the same impact on the symptoms. This is unprecedented – such a placebo effect hadn't been seen before in earlier studies on Circassia's cat allergy product, in any of its other potential allergy treatments, or indeed in competitors' studies in allergy. It is difficult to explain how and why such an effect has been seen but, while its management team conduct further investigations into the data, all further development of Circassia's allergy vaccines has been halted, other than the trials in house dust mite and birch allergy which are already well advanced.

This development led to Circassia's share price declining by approximately two-thirds during the period, making it a significant negative contributor to performance. We share the management team's clear disappointment at the trial results but remain supportive shareholders. There is much more to Circassia than its allergy business, and the combination of its net cash and the value of its recent acquisitions suggests that the shares have fallen further than they should have done. It is, equally, far too early to conclude that there is no value in the allergy technology platform.

US biotechnology company Alkermes also disappointed, with two phase III trials in ALKS-5461, a potential treatment for major depressive disorder, failing to meet their primary endpoints in January. Although one should expect a negative share price reaction to such news, the near halving of Alkermes' share price looked greatly overdone. With a further phase III trial still underway, this does not represent, by any means in our view, an outright failure of the drug. Meanwhile, Alkermes has made considerable progress in other parts of its business. Sales of Vivitrol, its on-market treatment for opioid dependence, for example, are gathering momentum, and it is making solid progress in other parts of its development pipeline. The shares have since staged an encouraging recovery but we believe they remain profoundly undervalued.

Elsewhere, the portfolio's largest holding, Prothena, declined by over 40 per cent during the period but this was not down to fundamentals. This is a business that we have known since it spun out of Elan in 2012. Indeed, as a shareholder in Elan for several years prior to Prothena's spin-off, my knowledge of its technology pre-dates its existence as a standalone company.

In recent months, newsflow on the development of Prothena's pipeline has been extremely encouraging, particularly for its leading asset, NEOD001, a potential treatment for AL Amyloidosis. Having performed very well in 2015, Prothena has this year been the victim of profit-taking, although much of its fall in 2016 can be traced back to the significant increase in the short interest in the stock. This has grown by three million shares and now stands at nearly 15 per cent of the total shares in issue. However, our investment focus is resolutely on the long term – not on the short term – and on the fundamentals of the business. News from the company during the period has significantly reinforced our positive view on the stock and we have taken advantage of this share price weakness to add to the Company's position in the company.

Northwest Biotherapeutics continued to decline during the period as sentiment towards the company remained weak in the absence of any news. We feel we have acted appropriately in raising governance issues at the company and continue to wait for it to inform its shareholders of its actions and developments in due course.

Positive returns

A number of health care businesses in the portfolio delivered positive returns, despite the challenging backdrop. Mereo BioPharma, for instance, was the largest positive contributor to performance, having successfully made the switch from unquoted to quoted during the period. Mereo is a UK–based specialty biopharmaceutical business founded in March 2015, which uses its in-house scientific expertise to seek out and acquire early-stage assets in therapeutic niches that major pharma companies are not focusing on. The company has thus far acquired three drug candidates from Novartis, each with different therapeutic indications, and will ideally add other opportunities to its portfolio as they emerge. We saw a substantial uplift on our original investment made in July 2015 and, although it's early days, the shares have traded positively since listing in early June (up 36.4 per cent to the end of the period).

Meanwhile, Theravance Biopharma, which was introduced to the portfolio in January, was rewarded for some encouraging development progress by a steady share price rise of 38.4 per cent during the period. The company was spun out of Theravance in 2014 and it retains a valuable economic interest in the future commercial potential of the respiratory franchise being developed in partnership with GlaxoSmithKline. The company has recently also reported positive results from a study of its Vibativ antibiotic, which indicates that it could have considerably wider applications than those it is currently approved for, including MRSA.

Outside of health care, Purplebricks delivered a positive contribution of 40.6 per cent over the period, following its Initial Public Offering (IPO) in December 2015, as the market became increasingly aware of its long-term potential and disruptive business model in the UK's estate agency market. Trading updates have confirmed continued strong growth and we are confident that they will continue. Moreover, we see the online estate agency model eventually overtaking the traditional model here in the UK. Purplebricks is uniquely well placed to capitalise on this structural shift in the estate agency market, which should deliver exceptional growth and excellent long-term returns to its shareholders.

Gigaclear, an unquoted business that builds and operates ultrafast internet access networks in rural communities and other areas that are a low priority for bigger market players, also performed well. We participated in a funding round which saw its valuation increase to reflect the significant progress it has made in expanding its internet access network. The long-term prospects remain highly encouraging for Gigaclear as the company doesn't have much competition in its target markets and will be able to generate very attractive returns once its network completes and adoption deepens within its communities.

Positive progress

Since the period end, there has been some meaningfully positive and noteworthy news from several portfolio companies. These include Prothena, which has announced further outstanding data on its potential amyloidosis treatment. In my view, this significantly derisks the registration trial for the drug, which should read out towards the end of this year. 4D Pharma is at an earlier stage than Prothena but is establishing itself as a leading player in the emerging field of live biotherapeutics. It has announced very encouraging analysis on its phase I trial into a potential treatment for irritable bowel syndrome which will allow it to progress to the next stage of its clinical development.

Within the unquoted element of the portfolio, we continue to see Oxford Nanopore making great strides in the development of its highly disruptive DNA sequencing technology, including sending the first sequencer into space to join the International Space Station. Meanwhile, Proton Partners is moving steadily towards introducing the UK's first cancer care centres offering proton beam therapy to patients by the end of 2017. Immunocore continues to progress several studies in its already well-validated immuno-therapy products and PsiOxus has secured a valuable partnership with Bristol-Myers Squibb, further validating its very promising oncolytic virus technology.

The positive progress doesn't end there but these six companies alone accounted for almost 30 per cent of the portfolio's net asset value at the end of the period. Each of them is, in our view, indicative of the exciting progress being delivered by the portfolio as a whole and the high long-term growth potential that awaits us.

New investments

We introduced several new holdings to the portfolio during the first half. These included Thin Film Electronics, a Norwegian company that specialises in printed electronics, an innovative new technology with a huge range of commercial applications, especially in relation to the 'internet of things'. We have known the company for a long time and are confident that it is poised for substantial growth as its technology becomes more widely adopted.

Among new unquoted positions were Metalysis, a titanium materials company serving the 3D printing industry, and Nexeon, a battery technology company with enormous potential to improve battery performance across a wide range of industries. We also participated in the IPO of Draper Esprit, a leading venture capital investment company involved in the creation, funding and development of high-growth technology businesses with a like-minded investment approach to our own.

These new investments were primarily funded by reducing the Company's exposure to larger, more liquid companies such as AstraZeneca, GlaxoSmithKline and Legal & General. The positions were sold to provide capital to take advantage of the profound and unjustified share price weakness that we have seen in businesses that are more appropriate for the Woodford Patient Capital Trust portfolio.

Exploiting opportunities

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Sometimes the share prices of quoted early-stage businesses will be volatile and they may sell off in small volume for no fundamental reason. We see these events as opportunities because share prices can, for long periods, become detached from reality. It is our job to exploit such opportunities, especially in circumstances where we believe that we have a very detailed understanding of the fundamentals of a business and its long-term potential. These are things which, in the short term, other market participants may deem to be supremely irrelevant to their decision making.

I understand that some investors will be disappointed with the performance so far, but it is early days for a strategy that is looking to exploit very long-term opportunities. Furthermore, although part of this performance is the result of fundamental developments, the majority of it is not.

This is, of course, an investment vehicle that invests predominantly in higher-risk enterprises which typically do not have profits, cashflows or dividends. As we have said before, not everything we invest in, small or large, will succeed. Some of the businesses we have invested in will encounter problems and sometimes things will go wrong. That will inevitably mean that some businesses are unable to fulfil the potential that we saw when we first invested in them.

Ultimately, however, it is critically important that we deliver what we have said we can achieve in terms of portfolio returns. We remain absolutely confident that we will deliver very attractive long-term returns from this portfolio and would like to thank our forward-thinking, long-term shareholders for their ongoing support.

Download the full interim report to 30 June 2016

What are the risks?

- Long-term outcomes are more binary – extremely attractive rewards for success but some businesses will inevitably fail to fulfil their potential and this may expose investors to the risk of capital losses
- As it can take years for young businesses to fulfil their potential, this investment requires patience
- The value of the trust as well as any income it pays will fluctuate which may partly be the result of exchange rate changes
- The price of shares in the trust is determined by market supply and demand, and this may be different to the net asset value of the trust. This means the price may be volatile in response to changes in demand
- The trust may invest in overseas securities and be exposed to currencies other than pound sterling – as a result, exchange rate movements may cause the sterling value of investments to decrease or increase
- The trust may invest in unquoted securities, which may be less liquid and more difficult to value, because they are generally not publicly traded – the lack of an open market may also make it more difficult to establish fair value
- Young businesses have a different risk profile to mature blue-chip companies – risks are much more stock-specific, which implies a lower correlation with equity markets and the wider economy

Important information

We do not give investment advice so you need to decide if an investment is suitable for you. If you are unsure whether to invest, you should contact a financial adviser. The trust currently intends to conduct its affairs so that its securities can be recommended by IFAs to ordinary retail investors in accordance with the FCA's rules in relation to non-mainstream investment products and intends to continue to do so for the foreseeable future. The securities are excluded from the FCA's restrictions which apply to non-mainstream investment products because they are shares in an investment trust.

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